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REPORT

ON

The Proposed Establishment

OF

A CENTRAL BANK
FOR HYDERABAD

BY

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197

CONTENTS

REPORT ON THE PROPOSED ESTABLISHMENT OF A CENTRAL BANK FOR HYDERABAD

CHAPTER I

INTRODUCTORY.

In obedience to Firman-e-Mubarak dated the 7th Rajab, 1366 H., I have been placed on special duty for a period of six months from the 1st Amerdad, 1356 F. to prepare a scheme for the establishment of a Reserve Bank for Hyderabad, on the following lines, for consideration of Government :—

(1) To take over complete management of currency, including paper currency ; and, with the assistance of expert staff in its Economic Section, to advise Government on the total volume of currency to be made available at a particular time in the State.

(2) By determining the total volume of currency to be made available, to assist in the determination of exchange rates of O.S. currency as against B.G. and other foreign currencies, based on the volume of trade and transactions.

(3) To take charge of public loans and to advise Government on the floatation of laons.

(4) To take charge of Government's surplus investment operations.

(5) To control and supervise the banks by introducing legislation, providing the scheduling of banks and controlling the deposits and the advances of scheduled banks and to determine a suitable rate from time to time and make it effective.

2. In pursuance of the above, and after a careful examination of the constitutional changes in India and its probable effects on the financial and economic conditions in Hyderabad and a detailed study of the present constitution and working of the Hyderabad State Bank in relation to the State currency, I have come to the conclusion that, in the interests of all concerned, the Hyderabad State Bank should immediately be converted into a

state-owned institution, having the right of note issue, in addition to its present central banking and commercial functions.

3. The above conclusions are based on :—

(1) discussion of the proposal with the Governor of the Reserve Bank of India,

(2) opinions of experts and the Report of the Agent-General for Hyderabad in London, on the discussions he had with the experts in London, and

(3) discussions with Mr. A. D. Shroff, a Director of Messrs. Tata Sons, Ltd. and one of the signatories of the Bombay Plan and other bankers and industrialists, both in Bombay and in Hyderabad.

CHAPTER II

The Rise of Central Banking.

4. In many of the older countries, one bank gradually came to assume more and more the position of a Central Bank, due mainly to its enjoying the sole or the principal right of note issue and acting as the Government's banker and agent. The Bank of England was the first Bank of Issue to assume the position of a Central Bank and to develop what are now generally recognised as the central banking functions. In various countries, during the course of the nineteenth century, the State either endowed an existing bank with the sole or principal right of note issue, or caused a new Bank of Issue to be established with special powers and privileges, accompanied by varying degrees of State control and supervision. Thus, by the end of the nineteenth century, almost every country in Europe, along with Japan, Java and Persia in the East, and Egypt and Algeria in Africa, had established a Bank of Issue, with special privileges and powers. All these banks became the bankers and financial agents of the Government of their respective countries ; and, in different ways or in varying degrees, they also assumed the other functions which were developed by the Bank of England and which have come to be regarded as essential functions of central banks.

5. As regards their relations with customers, other than Governments and banks, the range of business varied from that of the Bank of England, which by the

end of the nineteenth century had already come to give up most of its commercial banking business and to deal mainly with operators in the money market, to that of the Bank of France which had a large number of branches and conducted a larger business with regular customers, including many small tradesmen all over the country. In regard to their constitutional relationship with the State, the Bank of England again stood at the one end, a privately owned institution (converted into a state-owned institution in March, 1946), while at the other end was the Bank of Russia, a state-owned institution, managed by Government nominees and supervised by Government officials.

6. In 1914, a central banking system was established for the United States of America in the form of twelve Federal Reserve Banks, each having authority over a defined area, with a co-ordinating Federal Reserve Board at Washington. Provision was made for State participation in the administration of the Federal Reserve System, through the appointment of the members of the Federal Reserve Board by the President of the United States, and then through the appointment by the Federal Reserve Board, of three out of the nine Directors of each Federal Reserve Bank, including the Chairman.

7. When the International Financial Conference met in Brussels in 1920, one of the resolutions it passed was that " in countries where there is no Central Bank of Issue, one should be established". In the following years, the advice of the Brussels Conference was widely followed. New central banks were formed and many existing banks drastically overhauled. These banks were granted a monopoly of note issue and became the fiscal agents of the Government, the banks of re-discount and reserve and the lenders of last resort or bankers' bank in their respective territories.

8. Thus, during the next eighteen years, from 1921 to 1938, as many as 26 central banks were formed in the newly created states of Europe and in the countries of the New World. At present, with the exception of Brazil and Cuba, there is no country in the Old or the New World, which has not set up a Central Bank of its own. Moreover, Brazil and Cuba have the establishment of a Central Bank under consideration. This state

of affairs must be attributed to the growing realisation that under modern conditions of banking and commerce, it is a great advantage to any country, irrespective of the stage of economic development, to have centralised cash reserves and the control of currency and credit vested in one bank which has the support of the State and is subject to some form of State supervision and participation, whether directly or indirectly. Another factor is the realisation that a Central Bank offers the best means of communication and co-operation between the banking system of one country and that of another.

9. The centralisation of cash reserves in the Central Bank is a source of great strength to the banking system of any country. Centralised cash reserves can at least serve as the basis of a larger and more elastic credit structure than if the same amount were scattered among the individual banks. It is obvious that, when bank reserves are pooled in one institution which is, moreover, charged with the responsibility of safeguarding the national economic interest, such reserves can be employed to the fullest extent possible and in the most effective manner, during periods of seasonal strain and in financial crisis or general emergencies.

10. The centralisation of cash reserves is conducive to economy in their use and to increased elasticity and liquidity of the banking system and of the credit structure as a whole. In the absence of a Central Bank and centralised reserves, each of the commercial banks would, for example, have to carry more cash in order to cope with seasonal strains and possible emergencies than if there were a Central Bank from which the banks could, directly or indirectly and individually or collectively, obtain the necessary accommodation at such times. In short, with a Central Bank to fall back upon in case of need, the commercial banks can, with safety, conduct either a larger volume of business with the same cash reserves or the same amount of business with a smaller reserve than if they have to depend only on their own individual resources and on such money market facilities as are available. The important point about centralised cash reserves is, however, that they serve to increase the capacity of the Central Bank to rediscount or otherwise create credit for the purpose of meeting the cash requirements of the commercial banks or of the money market generally.

CHAPTER III

ESTABLISHMENT OF A STATE-OWNED CENTRAL BANK OF ISSUE.

11. The management of the State currency by the Finance Department of H.E.H.'s Government is not considered by any one to be a failure. The successive Finance Members have left their impression upon the financial system of Hyderabad. Sir Casson Walker and Sir Akbar Hydari have controlled the currency policy of Hyderabad in a manner which not even Sir Basil Blackett or Sir George Schuster can cavil at. Within the limits prescribed by the constitution, they administered the financial policy with success and supplied to the country the necessary currency. So far as financial stability is concerned, they did their work with wonderful success and with genuine sympathy. They even entered upon the banking functions of expanding currency by discounting commercial bills during the season, through the agency of the Imperial and Central Banks and, in recent years, through the Hyderabad State Bank, who, under the Hyderabad State Bank Act, have been given full control over the management of the State currency, as agents for Government. But, as the State Bank is getting highly commercialised, it is now necessary to separate the management of the State currency from other commercial functions of the Bank.

12. While submitting the proposal for the establishment of a Reserve Bank for Hyderabad, the Hon'ble Finance Minister had suggested that a separate Bank to perform central banking functions should be started, which would be a national concern owned by the State and completely managed by Government and which would be in keeping with the policy that is being followed elsewhere, such as, the nationalisation of the Bank of England and the proposed nationalisation of the Reserve Bank of India.

13. If expediency is a final word in politics, the revival of the proposal to constitute a Reserve Bank for Hyderabad which will, in the main, carry out the functions of a Central Bank, must be welcome. Sooner or later, a Reserve Bank must be constituted to regulate the control of the credit and currency policy of the State,

before any advance can be thought of in constitutional experiments. Years ago, economists in England have put in a powerful plea for the socialisation of central banks as publicly-owned corporations "using a capital owned by the State and administered by persons nominated by the State", so that the "ultimate control of matters of high policy should rest with the Government, but the detailed administration of this policy be free from Government interference in the hands of those appointed to control the affairs of the Bank". The more recent policy has been not only to vest the appointment of the Board with the Government, but also the power of dismissal of its members and to appoint a Minister of State responsible for the affairs of the Bank.

14. In the East as in the West, a school has risen, which has adherents from among the best intellectuals of the age, to socialise the banks and make them national institutions and not mere private concerns to subserve the purpose of the plutocracy as they now are. It is their view that the credit and currency policy of each country must be managed in the best interests of that country, instead of handing over the entire machinery for credit and currency expansion to the custody of one or two representative bankers, with a few advisers forming a Board. A State Bank, taking over the entire management of currency, with a Board of Management nominated for a term by Government, with the capital subscribed by Government, would place the working of the Bank under the scrutiny of the Finance Department and the Executive Council and the supervision in matters of policy in the Legislature, which is representative of the people of the State. Such a Bank would pursue and adopt a line of action which might subserve national as opposed to sectional interests.

15. To achieve this end, we shall have to organise an institution and place with it the entire currency resources of the State. We shall have to give it the right to issue notes under conditions which, of course, shall be regularised by an Act of the Legislature. We shall have to place with it the use of the revenues of the land, including receipts from such activities of the State as the Railways and other public-utility concerns. We shall have to clothe the Bank with the authority of a Government institution, thereby attracting to it all the

liquid capital of the Dominions. The actual means by which such a result can be achieved is deserving of more detailed consideration and I shall revert to it later in this Report.

16. While the constitution and range of statutory powers differ to no small extent, all the so-called central banks show a tendency, in practice, to conform to an almost uniform pattern in respect of their functions and methods. The methods vary in degree, depending upon whether the Central Bank operates in a country which has a highly developed money market that serves as a world market, as in London and New York, or a subsidiary money market, or no organised money market at all; but underneath these variations, there lies a measure of uniformity in practice, and central banks are to be found all over the world with more or less the same outlook on monetary and banking matters and the same regard for certain traditional conventions.

17. Central banking has become an entirely separate branch of banking, as compared with commercial banking, industrial banking and agricultural banking. It has developed its own code of rules and practices and the existence of a science of central banking has been acknowledged by many. A Central Bank is generally recognised as a Bank which performs, in the national economic interest, the following, functions:

(1) The regulation of currency in accordance with the requirements of business and the general public, for which purpose it is either granted the sole right of note issue or at least a partial monopoly thereof.

(2) The performance of general banking and agency services for the State.

(3) The custody of the cash reserves of the commercial banks.

(4) The custody and management of the metallic currency of the State and of the country's reserves of international currency.

(5) The granting of accommodation in the form of re-discounts of bills of exchange, treasury bills and other suitable paper offered by the commercial banks and the general acceptance of the responsibility of lender of last resort.

(6) The settlement of clearance balances between the banks.

(7) The control of credit in accordance with the needs of business and with a view to carrying out the broad monetary policy adopted by the State.

18. A further requisite of a real Central Bank is that it should not, to any great extent, perform ordinary commercial banking transactions, such as accepting interest bearing deposits from the general public and accommodating a large number of regular commercial customers with discounts or advances. There are, however, a number of central banks as the Bank of France, the Bank of Japan, the Bank of Finland, the Commonwealth Bank of Australia and the National Bank of Egypt, who perform certain commercial functions ; but, in recent years, it has come to be recognised that the success of a central bank depends largely upon the whole-hearted support and co-operation of other banks and that such co-operation can be effectively obtained only if the Central Bank refrains from competing directly with the commercial banks in their ordinary banking business, except when compelled to do so in the national economic interest. A true Central Bank should, however, be ready to perform ordinary commercial functions, in addition to its central banking functions, if the conditions and circumstances in its area of operation render it necessary or desirable for it to do so. The guiding principle for a Central Bank, whatever function or group of functions it performs at any particular moment, is that it should act only in the public interest and for the welfare of the country as a whole and without regard to profit as a primary consideration.

19. The State owns the entire capital of the following central banks :—

(1) Commonwealth Bank of Australia,
(2) National Bank of Bulgaria,
(3) Bank of Canada,
(4) Central Bank of China,
(5) National Bank of Denmark,
(6) Bank of England,
(7) Bank of Finland,
(8) Bank of Latvia,

(9) Reserve Bank of New Zealand,
(10) State Bank of Russia,
(11) Riksbank of Sweden.

20. Among the central banks which are still owned by private shareholders are the following :—

(1) National Bank of Belgium,
(2) Bank of France,
(3) Reichsbank of Germany,
(4) Reserve Bank of India,
(5) Bank of Japan,
(6) Netherlands Bank,
(7) Bank of Norway,
(8) Bank of Portugal,
(9) Bank of Spain.

21. In sharp contrast with the situation which prevailed for a number of years after the last world war, the State has, in several countries, manifested a strong tendency in recent years, to claim a larger extent of participation in the ownership and administration of the Central Bank. In Denmark and New Zealand, the former privately-owned central banks were converted into entirely state-owned central banks in 1936. In the same year, the Government of Canada took steps to acquire a controlling interest in the capital of the Bank of Canada and the process of conversion into a state-owned institution was completed when the Government paid out all the private shareholders. It is significant that such changes were made in the statutes of two newly established central banks, the Reserve Bank of New Zealand and the Bank of Canada, within two years from their inception, as well as in the statute of one of the oldest central banks, the National Bank of Denmark.

22. The trend towards greater State participation and control is, however, to be observed not only from the statutes of many central banks, but also from increased State intervention in matters of monetary and banking policy. This trend towards increased State intervention and pressure was enhanced in 1930, under the stress of the world-wide depression and its aggravation by the financial crisis in Central Europe in the middle of 1931, and was accentuated by the suspension of the gold

standard over almost the entire globe. In many cases, central banks were virtually obliged to provide the financial facilities demanded by the State and a perusal of the balance sheets of many central banks today reveals the existence of not only direct state debts, but also of large holdings of Government securities and treasury bills, as investment and collateral for advances.

23. In general, however, mere statutory provision for the independence of the Central Bank has not proved to be sufficient. There are examples of state-owned central banks which are operated as autonomous institutions and are known to have suffered less intervention and pressure from the state in difficult times than some central banks in whose capital and management the state has a minority share. In other words, the particular constitution of the Central Bank is not the only important matter to be considered. Another and more important matter is the attitude of the Government towards the Central Bank, irrespective of the constitution of the former or the latter. On the Government, therefore, falls the onus of establishing or maintaining the tradition of political independence on the part of the Central Bank.

24. It is, however, time people stop talking in disparaging terms of political influence on the working of the Bank. One fails to see how any Central Bank can be free from any political influence whatever. Men's minds cannot be divided into so many watertight compartments, wherein may be sorted their views on politics and finance. Apart from the technical aspect of banking, broad questions of policy are matters of political issue and a politician cannot view them as a banker pure and simple, forgetting his status as a citizen and a member of the body-politic. The close connection and interaction between politics and banking are increasingly felt in every country where central banks are functioning. The Federal Reserve System of the United States of America is an object lesson of the co-ordinated efforts of the political and banking talents of the state. The Secretary of the Treasury and the Comptroller of the Currency are members ex-officio of the Federal Reserve Board and six members are appointed by the President with the advice and consent of the Congress. The Secretary of the Treasury is further appointed Chair-

man of the Board during his term of office. The governor and the two Deputy Governors of the Bank of France are appointed by the President of the Republic on the recommendation of the Finance Member and, because of the relationship subsisting between the Bank and the State, the latter has always claimed a share in its government and a right of intervention in the administration of its affairs. The system prevailing in these two countries is typical of the position of central banks in other countries with certain minor modifications; but the relationship between the central banks and their respective Governments is always close and intimate. The State having conferred the invaluable right of note issue to the banks, it cannot be too vigilant and careful as to how that right is being used. We should not, therefore, be entrapped in a system which British India is considering to abandon in respect of its Reserve Bank.

25. The demand for nationalisation of the Reserve Bank of India has been repeatedly voiced in the Central Assembly. On every conceivable occasion someone or the other has demanded nationalisation of the Bank. At the Budget Session of the Central Assembly in the beginning of this year, Mr. Sarat Chandra Bose, the then leader of the Congress Party in the House, found fault with the Government for not having put forward the proposals to nationalise the Reserve Bank. Mr. Manu Subedar, another congressman, has constantly demanded an early move in this matter, every time he has spoken on any subject having some relation to banking, finance or foreign exchange. Some of the members of the Select Committee of the Banking Bill also had pleaded for nationalisation of the Reserve Bank. This demand, of course, has not been a monopoly of the Congress Party alone, for some of the members of the Muslim League, too, have been pressing for it. There is thus a considerable section among the legislators which has been advocating not only state control of the Reserve Bank, but also its ownership.

26. The points made by those who supported the proposal are as follows :—

(1) Is the Reserve Bank to be run in the interests of that limited number of capitalists who are shareholders, or is it to be run in the interests of all people of the land ? If the latter, then there is no reason

why the Reserve Bank should not be taken over by the Government.

(2) The Reserve Bank would provide finances much needed by Government, if it were to be completely nationalised.

(3) A Reserve Bank has not carried out its statutory obligations to create a discount market. It has not carried out its obligations to recommend a permanent basis of the monetary system. It has failed to improve the machinery for dealing with agricultural finance and for bringing a closer connection between agriculture and the operations of the Bank.

(4) The Reserve Bank did not always have the power to help small banks in difficulties, some of which would have survived, had they received assistance earlier.

(5) The only point in its favour can be that, being a shareholders' Bank, it may be a safeguard against Government using the institution as a printing press for replenishing its finances; but this too has been proved otherwise during the war.

27. The Government's stand on the question, however, still seems to be inconclusive. The Hon'ble Finance Member has, however, given an assurance that Government would give its most careful and sympathetic consideration to the proposal and that if it was convinced that nationalisation of the Reserve Bank would be in the interests of the country, it would not hesitate to take steps in that direction.

28. The position in Hyderabad is somewhat different. The complete independence of the Central Bank is an ideal which countries like Hyderabad can only approximate in different degrees, according to the state of economic development and the sense of responsibility inherent in their public and, particularly, their commercial life. Hyderabad, at any rate, has not reached that stage of economic development when the State could stand aside altogether, either as regards the composition of the Bank's direction or as regards the shaping of the relations between the Bank and the State. The general idea behind the system, which is briefly enumerated in subsequent chapters, is to make full use of the credit of the State and to see that the economic resources of the

Dominions are put to the utmost advantageous use possible in the interests of the people.

CHAPTER IV

Conversion of the Hyderabad State Bank into a State-owned Institution—Opinions of Experts.

29. In an Explanatory Memorandum dated the 26th Thir, 1356 F. (Annexure 'A'), which I had prepared for discussion with the Governor of the Reserve Bank of India, I have given a brief account of the currency of the State and also the present constitution of the Hyderabad State Bank and have suggested that, instead of starting a separate Central Bank of Issue, the Hyderabad State Bank should be nationalised and divided into two separate Departments, namely, the Issue and the Banking Departments, and that the former may be entrusted with the right of note issue, and the latter kept free to conduct commercial banking under certain conditions and restrictions. The proposal was discussed in its various aspects, first, with the Managing Director of the Hyderabad State Bank and later, with Sir Chintaman Deshmukh, the Governor of the Reserve Bank of India. In the course of discussions, it was explained that the Hyderabad State Bank was started about five years ago with the object of taking over central banking functions, as agents for Government, in addition to its commercial functions. It was then thought that H.E.H.'s Government would be in a position to decide whether the right of note issue should also be entrusted to the Hyderabad State Bank, after watching its progress in the first ten years of its existence. It was also thought that the constitutional position of India would be settled within that period. Things have, however, moved more rapidly than what was anticipated and a situation has now arisen which has necessitated an immediate decision with regard to our currency.

30. It was further pointed out that, as explained in the Memorandum (Annexure 'A'), almost all the central banking functions have already been entrusted to the Hyderabad State Bank, as agents for Government, and although, under the Hyderabad State Bank Act, Government is required to exercise full control over the management of the State currency by the Bank, in actual

practice, the so-called Government control is purely nominal. The question, therefore, arises whether it would be necessary to start a separate Reserve Bank for Hyderabad, leaving the present Hyderabad State Bank to perform purely commercial functions, or whether it would be advisable to combine both the functions in one and the same institution, under certain conditions and restrictions. Sir Chintaman Deshmukh agreed that by separating the central banking functions in a separate institution, the prestige and status of the Hyderabad State Bank would be considerably affected and when the Government cash as well as the currency balances are taken away from it, it would be difficult for the Hyderabad State Bank to carry on its ordinary commercial functions. He was of opinion that it would be difficult for the State Bank to undertake discounting of bills and other exchange transactions, when the Reserve Bank, as a separate authority for note issue, would not be able to grant the State Bank any special concessions, and the State currency would be supplied at a fixed rate of exchange to all the Joint Stock Banks functioning within the State. He also agreed that the difficulties of securing trained staff and a suitable building are so great that it would not be possible to start a separate Reserve Bank in the near future. After examining the question in its various aspects, he suggested that a constitution may be safely evolved on the lines of the Commonwealth Bank of Australia, specially when it is intended to organise, at a later stage, under the same management, separate sections for industrial and agricultural credit. He was of opinion that if it was proposed to carry on the central banking functions and the commercial banking in one and the same institution, the Bank should preferably be nationalised and run as a State institution. He also agreed that if the Reserve Bank was started as a separate institution and special concessions are proposed to be given to the Hyderabad State Bank, it would be difficult for H.E.H.'s Government, under the present political conditions, to obtain the approval of the State Legislative Assembly to the revised enactment.

31. In the Memorandum (Annexure 'A'), I had suggested that the Issue and the Banking Sections should not only be kept separate, but there should be two different controlling authorities and a separate body of expert advisers. The Governor of the Reserve Bank of India

did not agree with this suggestion. He was of opinion that when it is proposed to start two separate departments in one and the same national institution, it would be necessary to place both of them under a controlling body, consisting of Government nominees, the nominees of the elected representatives of the State Legislative Assembly and also the representatives of the commercial, industrial and agricultural interests.

32. When the proposal for the establishment of a Reserve Bank in Hyderabad was submitted to the Council, it was resolved that our Agent-General in London should be requested to consult some experts and send their opinions on the proposal for consideration of Government. A copy of the Memorandum (Annexure 'A') was, therefore, forwarded to the Agent-General in London for obtaining the opinions.

33. It appears from the report now received from the Agent-General in London that copies of the Explanatory Memorandum were given to :—

(1) Sir George Schuster, Director of the Westminster Bank and at one time Finance Member of the Government of India,

(2) Sir Charles Lidbury, Chief General Manager of the Foreign Department and Director of the Westminster Bank,

(3) The Hon'ble Mr. Rupert Beckett, Chairman of the Westminster Bank, who is one of the two or three top-ranking bankers in the City of London,

(4) Sir Cecil Kisch, who is the author of a book on Central Banking and who, about a year ago, retired as Economic Adviser to India Office, and

(5) Mr. Geofrey Crowther, the Editor of the 'Economist' which is one of the world's leading Journals on economics and finance.

34. In his letter dated the 25th June, 1947, addressed to the Agent-General, Sir Charles Lidbury, after an informal discussion with the Hon'ble Mr. Rupert Beckett and later, with Lord Catto, the Governor of the Bank of England, has given the following opinion :

"I refer to the Memorandum by the Additional Financial Secretary which accompanied your letter of the 11th June addressed to Sir George Schuster and to the interview which you had with the Honourable

Rupert Beckett, Chairman of Westminster Bank, at which I was privileged to be present.

Taking fully into account all the subject matter of the Explanatory Memorandum of the Additional Financial Secretary and the discussion which took place when you saw the Chairman of this Bank, I have discussed the general subject of the Memorandum with my Chairman and in other appropriate quarters and in the result I can, without the smallest hesitation, categorically recommend to the Ruler of Hyderabad and his Council of Ministers that the course which should be adopted is that which is set out in Item 15 of the Explanatory Memorandum referred to earlier in this letter."

35. While forwarding in original the above opinion of Sir Charles Lidbury, the Agent-General has reported as follows :—

"This opinion was given by Sir Charles Lidbury, who is himself one of the biggest names in London, after consultation with Hon'ble Mr. Rupert Beckett, the Chairman of the Westminster Bank and Lord Catto, the Governor of the Bank of England. Mr. Crowther to whom also I referred this matter had a preliminary discussion with me and is of the same opinion as expressed by the Westminster Bank. He has, however, referred the details to the 'Economist Intelligence Bureau' for a full report and suggestions on minor details which were promised by the end of July, but as I have been here, the report is not available. I shall be able to forward it by Air Mail as soon as I return to England which will be about the second week of August. However, as the opinion of these two eminent Bankers and financial experts is in favour of the proposal as drawn up by Khan Bahadur Taraporewala in his report which I have studied and with which I fully agree in conformity with my opinion from the beginning, I request that we may now proceed with the necessary legislation and other measures to give the proposal material form."

36. As the opinions of these eminent bankers and financial experts are in favour of the proposals as drawn up by me, I have proceeded to draft the revised constitution of the Hyderabad State Bank on the lines set out in Chapters V to XIV of this Report.

CHAPTER V

Constitution of the Bank.

37. The recent trend towards state-ownership and control of central banks is to be attributed primarily to the trend of public opinion in favour of direct state control of monetary and banking policy and, in some cases, also to the desire or need of Governments to take the line of least resistance and use the central banking machinery of credit creation for the purpose of the State. The Governor of the Reserve Bank of India has recommended that the constitution of the State Bank in Hyderabad might be evolved on the lines of the Commonwealth Bank of Australia, as the general economic conditions in both countries are more or less similar. According to the Commonwealth Bank of Australia Act, 1945, the Bank has been divided into the following seven separate departments :

(1) Central Banking Department—(Note Issue, etc.).

(2) General Banking Department—(Commercial Banking Section).

(3) Rural Credits Department—(Short-term Agricultural Credit).

(4) Mortgage Bank Department—(Long-term Agricultural Credit).

(5) Industrial Finance Department.

(6) Housing Loans Departments—(Loans to individuals and Building Societies).

(7) Savings Bank Department.

38. Sooner or later, Hyderabad will have to evolve a scheme of banking which would conform to a pattern almost identical to that of the Commonwealth Bank of Australia in respect of its functions and methods, and organise separate departments for industrial credit and a Land Mortgage Bank. It is, therefore, proposed to alter the present constitution on the lines of the Commonwealth Bank of Australia. Under the revised State Bank Act, the Bank would be divided into four separate departments, namely,

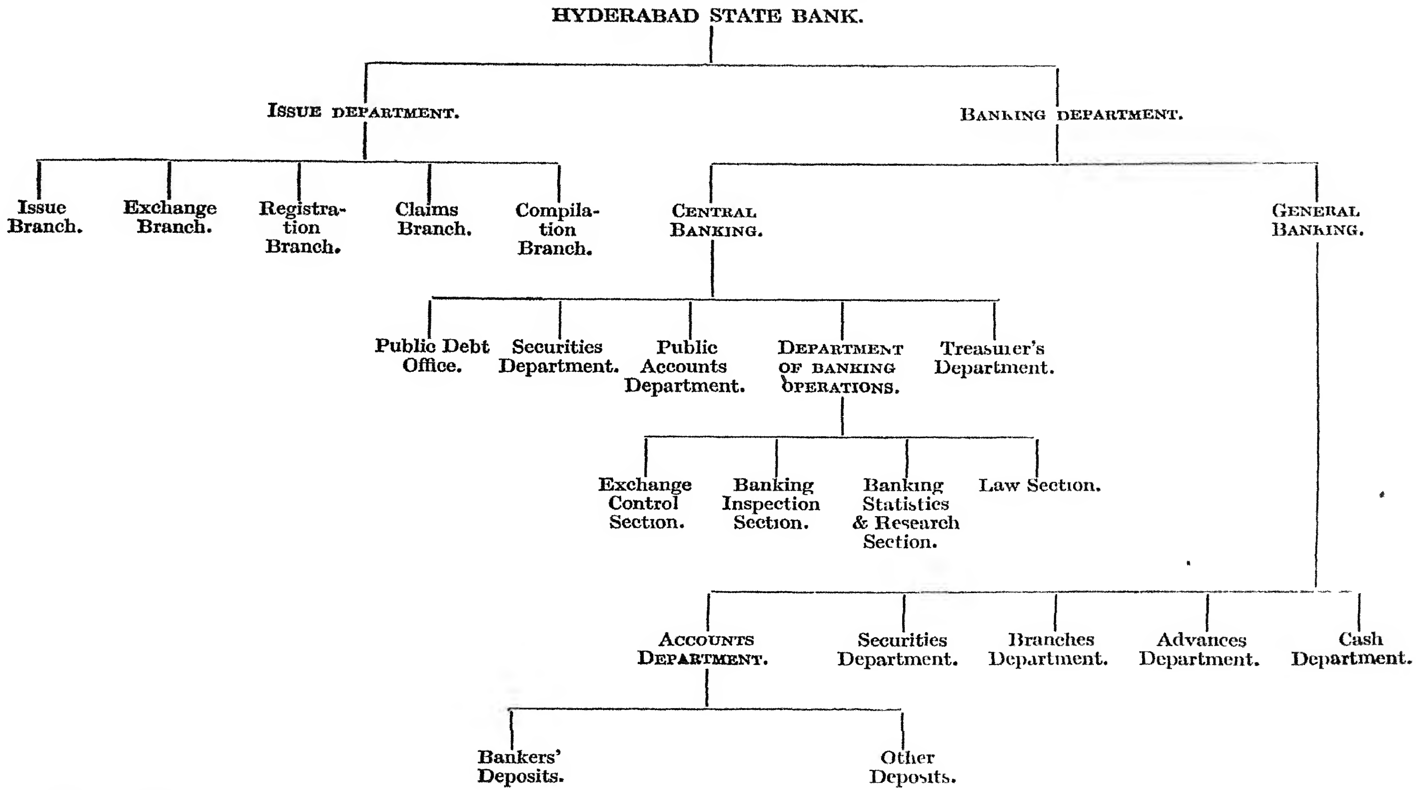
(1) Issue Department ;

(2) Banking Department—(Central and General Banking Departments);

(3) Industrial Finance Department; and

(4) Land Mortgage Bank Department for long-term agricultural credit.

39. Although provision will be made in the revised Act for the organisation of the four separate departments mentioned above, for the present, only the first two departments will be started—one dealing with the control and management of note issue and the other with central and commercial banking, under certain conditions and restrictions. When the arrangements for these two departments are completed, the question of organising the other two departments, namely, the Industrial Finance Department and the Land Mortgage Bank Department, will be taken up. As the Industrial Trust Fund is already providing industrial finance, both for big and small industries, it will be possible to transfer this section to the Hyderabad State Bank and to run it on proper banking lines, according to the provisions of the Act. Although the Land Mortgage Bank Act was passed in 1349 F., no action appears to have been taken to organise a Land Mortgage Bank under that Act. This Act will now be repealed and a Land Mortgage Bank organised, in due course, under the revised Hyderabad State Bank Act. For the present, the first two departments will be organised into separate sections as given below :—



Note.—Operations on the currency chests, both on account of the Central Banking Department and the General Banking Department, as well as the inter-branch adjustments on account of the General Banking Department, will be carried out in a separate section known as "Central Office."

40. In determining the revised constitution of the Hyderabad State Bank, the main consideration must be to provide a constitution that from its very nature be directed towards the furtherance of the public interest of the State and industry from the widest point of view and not as a political party or a financial group. To ensure this result, the composition of the governing body should be left entirely to the state and not to the decision of a particular party or group of shareholders, as is usual with a banking company. Definite regulations should, therefore, be laid down regarding the constitution of the governing body; but when once the governing body is appointed, it should be free from detailed interference on the part of the Government which should be confined to cases where its action infringes the terms of its charter. There should, however, be at all times, a close and continuous co-operation between the Government and the Bank when important issues are involved.

41. *Name.*—After the transfer of the right of note issue to the existing institution, the bank may be continued to be called by the name of the Hyderabad State Bank; but on account of the recent constitutional changes, if any alteration in the name of the Bank is considered necessary, it may be called the 'Bank of Hyderabad' or the 'State Bank of Hyderabad.'

42. *Objects.*—According to the preamble to the Hyderabad State Bank Act, 1350 F., the Bank was started with a view,

(*i*) to regulate the circulation of the currency;

(*ii*) to maintain, in the fullest degree, its stability and security;

(*iii*) to facilitate the payment of money in H.E.H. the Nizam's Dominions and abroad;

(*iv*) to provide credit necessary for the economic life of the country; and

(*v*) to encourage the growth of agriculture, commerce and industry.

43. The objects are fairly comprehensive, but as it is proposed to bring the Bank under the ownership and control of the Government and to entrust the Bank with

the right of note issue, as against their present function of regulating its circulation, as agents for the Government, the preamble may be amended as follows:—

> "WHEREAS it is expedient to constitute a State Bank for Hyderabad under the ownership and control of the Government to regulate the issue of bank notes, to maintain its stability and security, to provide credit necessary for the economic life of the country and to transfer to the Bank so constituted the undertaking of the Hyderabad State Bank;"

44. *Capital.*—In view of the fact that the Bank has to be entrusted with a complete monopoly of note issue and with the general control of credit in the economic interest of the country and that the major responsibility for the determination of monetary policy has come to be vested in the State, the latter has almost everywhere claimed the right to increasing participation in the affairs of the Central Bank. Such participation by the State should, for the reasons already explained in Chapter III, take the form of sole ownership of the capital of the Bank and the appointment of its directors and chief executive officers and a share in its profits, as in the case of the Bank of England, the Commonwealth Bank of Australia, the Bank of Canada, the State Bank of Russia, the Reserve Bank of New Zealand and other state-owned central banks.

45. Some of these central banks were not orginally state-owned banks. In fact, the Bank of England and the Bank of France which had been established as far back as 1694 and 1800, respectively, were only converted into State Banks in 1945-46. The Central Banks of New Zealand and Canada, on the other hand, were converted into State Banks, soon after their establishment as privately-owned banks. The shareholders of the Reserve Bank of New Zealand were repaid in Government stock or cash at the discretion of the shareholder and on the basis of the market valuation of the shares; and the private shareholders of the Bank of Canada were paid out in cash at the market price. Those of the Bank of England were paid in 3 per cent. Government stock of an amount sufficient to give them the same income as the average of the Bank's dividends over the preceding 20 years, namely, at the rate of £. 400 Government Stock for £ 100 Bank Stock.

46. Out of an authorised capital of rupees one and half crore, only rupees seventy-five lakhs have been issued by the Hyderabad State Bank, divided into fully paid shares of Rs. 100 each, the maximum holding by any individual, jointly or severally, being limited to 200 shares. The Government is, however, required to hold, at all times, shares of the face-value of 51 per cent. of the share capital issued by the Bank. Up to the end of 1355 F., the shares of the Bank were quoted in the market at about Rs. 160 to Rs. 165. But, on account of the unsettled political conditions in India, there has been an abnormal depression in the share market and, in sympathy with other shares, the price of the State Bank shares has come down to O.S. Rs. 128. As it would not be fair to pay off the existing shareholders at today's market price, I suggest that the 49 per cent. of the shares in the hands of the public should be purchased, after giving due notice, at such rate as may be fixed by Government. The excess payment will be met out of the Reserve Fund of the State Bank which, with the allotment from the current year's profits, should amount to rupees twenty-five lakhs.

47. As the Central Banking Department of the State Bank will undertake, in a separate section, to accept and hold monies for account of Government and to make payments on behalf of Government, and to carry out exchange, remittance and other banking operations in respect of those monies, the entire cash balances of Government will be transferred, on the opening day, to the Central Banking Department from the existing Banking Department. It will not be necessary to supply any funds by way of working capital to the Central Banking Department, as the Issue Department will be entirely separate from the Public Debt Office and the Public Accounts Department. The General Banking Department will, however, require a fixed working capital, for its day-to-day transactions, with definite arrangements for the supply of additional funds from the Issue Department, against re-discount of bills or Treasury Bills and deposit of Government securities, or documents of title to goods. After the right of note issue is entrusted to the State Bank, the General Banking Department will not be allowed to accept deposits at interest at its Head Office and branches within H.E.H. the Nizam's Dominions. This will reduce the present resources of the Department by

nearly rupees one crore. The only source which the General Banking Department can count on. for its working capital, would be their total current account balances, both from the banks and the general public. Taking into account the above deposits on the one hand and their average cash credits, loans and other advances on the other, it is estimated that the General Banking Department would require a fixed working capital of rupees two crores, with arrangements to obtain additional funds by issue of currency against rediscount of bills or Treasury Bills or deposit of Government securities, gold or silver bullion, or documents of title to goods, up to an amount not exceeding rupees four crores, at two per cent. below the bank rate. Any additional advance against the latter form of security will be granted at one per cent. below the bank rate and will require previous sanction of the General Council. The fixed working capital of rupees two crores will be provided from the 51 per cent. share of the Government in the existing capital of the Hyderabad State Bank amounting to Rs. 38,25,000 (Rupees thirty-eight lakhs and twenty-five thousand), and the balance of Rs. 1,61,75,000 (Rupees one crore sixty-one lakhs and seventy-five thousand), from the O.S. Stabilisation Reserve, as suggested in Chapter VIII of this Report. The existing Reserve Fund of the Bank, after payment of the premium on the 49 per cent. shares held by the public, will form the nucleus of the General Banking Department Reserve Fund referred to in para. 51 of this chapter.

48. The capital of the Industrial Finance Department, when organised, will be the amount of capital of the Industrial Trust Fund immediately prior to the transfer of the Fund to the Hyderabad State Bank. The capital of the Land Mortgage Bank Department, when organised, will be raised, in the form of debentures of the aggregate value of O.S. rupees two crores. These debentures will be issued from time to time for rupees five lakhs or multiples thereof, on the guarantee of Government, and at a rate of interest to be fixed by the Bank. Both the Industrial Finance Department and the Land Mortgage Bank Department will have the authority to take advances, either from Government or from the General Banking Department, of such amounts and subject to such terms and conditions as are agreed upon between the parties.

49. *Distribution of Profits.*—In the case of almost all the state-owned central banks, the balance of profits, after providing for a maximum allocation to the Reserve Fund, is to be paid to the State. It was provided, for example, that the Riksbank of Sweden was to place 10 per cent. of its net profit to the Reserve Fund, until it amounted to 20 million kronors, while the National Bank of Bulgaria could set aside 20 per cent. of its profits for the Reserve Fund, until it amounted to the original capital, and 5 per cent. for the Pension Fund. The nationalised Bank of England, on the other hand, is to pay to the Treasury, the whole of the profits of the Issue Department and a half-yearly sum of £ 8,73,000 out of the profits of its Banking Department, being the equivalent of the customary half-yearly dividend of 6 per cent. previously paid to its shareholders.

50. Following the principle adopted by the Bank of England after nationalisation, it is suggested that the entire profits of the Issue Department should be paid to Government, after making provision for depreciation in assets, contributions to staff and superannuation funds and such other contingencies as are usually provided for by bankers, in respect of the Issue Department and the Central Banking Department.

51. The net profits in each year, arising from business carried on in the General Banking Department of the Bank, after making provision for depreciation in assets, contributions to staff and superannuation funds, etc., may be dealt with as follows :—

(1) One-quarter to be placed to the credit of the General Banking Department Reserve Fund ;

(2) One-quarter to be transferred to the capital of the General Banking Department ; and

(3) One-half to be paid to Government on the basis of their investment of 51 per cent. in the present share capital of the Bank.

52. As the Government will not be required to provide fixed capital for the Industrial Finance Department and the Land Mortgage Bank, provision will be made in the revised Hyderabad State Bank Act, for the profits of these departments to go towards building up their capital up to a fixed amount and reserves.

*Administration.**

53. *Chief Executive Officers.*—The Chief Executive Officers of the majority of central banks are appointed by the Government, either on its own initiative or with the advice of the Board of Directors. As examples of appointments by the Government on its own initiative, may be mentioned the Bank of France, whose Governor and two Deputy Governors are appointed by the President of the French Republic ; the Bank of Japan, whose President and Vice-President are appointed by the Government with the approval of the Emperor ; the South African Reserve Bank, Reserve Bank of New Zealand and Commonwealth Bank of Australia, whose Governors and Deputy Governors are appointed by the Governor-General ; and the Bank of England, whose Governors and Deputy Governors are, under the Act of 1946, appointed by the King, instead of being elected by the Court of Directors, as was formerly the case. Moreover, in the case of some central banks, it has been laid down by statute that the Governor and Deputy Governor shall be " men of proven financial experience " as in Canada, or, " persons possessed of actual banking experience," as in New Zealand.

54. With regard to the period of years for which the Chief Executive Officers are appointed, they vary from one year in the Central Bank of Chile to three years in the Riksbank of Sweden ; four years in the Reichsbank ; five years in the Bank of England, the Federal Reserve Banks, the Bank of Japan and the Reserve Bank of India ; six years in the National Bank of Rumania and the Bank of Portugal, and seven years in the Commonwealth Bank of Australia, Reserve Bank of New Zealand, Bank of Canada and Central Bank of Ireland.

55. *Board of Directors.*—With a few exceptions, such as Reichsbank and the Bank of Finland, which have only Boards of Management, every central bank has a Board of Directors or the equivalent of such a Board, whether called a Council of Administration or a General Council or a Supervisory Council.

56. The number of Directors of the Central Bank varies from six in Sweden to forty in Switzerland. There are eight in New Zealand, Bulgaria and Ireland, nine in

Belgium, South Africa and the United States, ten in Japan, Portugal and Rumania, eleven in Canada, twelve in Argentina, thirteen in India and Hungary, fifteen in Norway, sixteen in England.

57. With regard to the extent of participation of the State in the appointment of Directors, a distinction is made between entirely state-owned central banks and others. In the case of the former, all the Directors are appointed in England by the King; in New Zealand by the Governor-General; in Ireland by the Minister of Finance and in Canada by the Minister of Finance with the approval of the Governor-General-in-Council.

58. Mr. Gregory in his book, "Gold, Unemployment and Capital," has emphasised that "the directorate of a central bank should be free from sectional pressure of all kinds" and that "there is a great difference between appointing individuals, because they have a large experience in a particular branch of economic activity, and appointing them as representatives of that particular body of experience." It is also appropriate to refer to a section in the statute of the Central Reserve Bank of Peru which states that "every Director, no matter by whom appointed or elected, shall be considered a representative of the Nation and shall always vote for what he considers to be the general public interest." There is no doubt that the great importance of the central banking functions to the material well-being of the Nation, makes it necessary that such a bank should be subject to state supervision and control, but not in such a manner as to render it subservient to the will of the Government and the Legislature, who are at times tempted by political expediency to embark upon monetary policies which would, in the long run, be highly detrimental to the national economic welfare. While the Government admittedly should lay down the monetary policy of the country, the central bank is obviously in the best position to assist the Government in the formulation and carrying out of such policy. From this point of view alone, it is in the interest of the Government and the country as a whole, to get independent advice and an objective judgment from the Central Bank on such vital and complicated matters as money, banking and exchange. Thus, where a bank is, in the interests of the country, converted into a state-owned bank, care should be taken that it does not become exposed to politi-

cal pressure and so closely associated with the Government and the Legislature that it will lose its independence of judgment and its objective outlook on monetary and banking matters. In short, it is important that the Central Bank, though state-owned, should be left free to operate as an independent entity. It will be better able to attend to the service of the general good if the operation of state authority is invisible.

59. Keeping in view the administrative machinery adopted by central banks in countries whose economic conditions are, more or less, similar to those prevailing in Hyderabad, it is suggested that the day-to-day administration of the Bank should be entrusted to a Managing Director and not more than two Deputy Managing Directors who will be full-time servants of the Bank, and will be appointed by the Government for a period not exceeding five years, on such terms as Government may decide, and the period of their service may be extended, at the discretion of Government, by such further periods not exceeding five years in each case. The general superintendence and management of the affairs of the Bank, after its nationalisation, should be entrusted to a Council of Administration, consisting of the Hon'ble Finance Minister, Hon'ble Minister, Commerce and Industries Department, the Financial Secretary, the Managing Director and the Deputy Managing Directors; but with respect to the monetary and banking policy of the Bank, there should be a General Council, consisting of—

(1) the members of the Council of Administration;

(2) three members to be nominated by Government from the elected representatives of the Legislative Assembly; and

(3) three members to be nominated by Government, representing commercial, industrial and agricultural interests.

The Hon'ble Finance Minister will be the President of the Council of Administration and the General Council. The Council of Administration will meet at least once a week and the General Council once a month, to consider all matters referred to them.

60. A member nominated under (2) and (3) above, shall ordinarily hold office for three years or thereafter,

until a successor is duly nominated. He shall be eligible for re-nomination. A member once nominated, shall not be removed from office unless :

(*i*) he is disqualified for lunacy, insolvency, etc., or accepts an employment in a bank, or becomes a Director of any other Bank ; and

(*ii*) in the case of the members nominated from the elected representatives of the Legislative Assembly, he ceases to be a member of the Legislature.

61. The Industrial Finance Department and the Land Mortgage Bank, when organised, will each work under a Secretary and, for purposes of administration, they will be under the supervision of the Council of Administration and all matters of policy, as in the case of the other two departments, will be referred to the General Council. The Secretary to Government, Commerce and Industries Department, will attend, as a member, the meetings of the Council of Administration and General Council at which the affairs and the business of the Industrial Finance Department are considered and will have power to vote on all matters relating to the Industrial Finance Department. Similarly, the Minister in charge of the Revenue Department of the Government (Rural Reconstruction and Co-operative Department), will attend, as a member, the meetings of the Council of Administration and General Council at which the affairs and business of the Land Mortgage Bank Department are considered and will have power to vote on all matters relating to that Department.

CHAPTER VI.

Monetary Policy of the State.

62. The crisis through which the world is now passing is an unprecedented one, not only in its causes but also in the vicissitudes of its operation and the consumer is suffering acutely from scarcity. There is a general dearth of finished goods turned out from manufactories and of primary products. The demand for both has so outgrown the supply that almost all the countries in the world have taken practical steps to increase their production. In this deplorable state of things and the constitutional changes in India, what is to be the monetary objective of Hyderabad ? It is upon the solution of this

fundamental question that a rational scheme of a Central Bank for Hyderabad can be founded. It may now be taken as certain that the gold standard is dead. Even in the pre-war period, European countries had developed schemes for a gold exchange standard, the object of which was to keep only sufficient reserves for international payments, leaving internal demand for money to be met by inconvertible paper. The place of gold has been taken by sterling and dollar, till the world situation shows improvement.

63. The final negotiations regarding the settlement of India's sterling balances are expected to take place in London in the current month. It is stated in this connection that while the general lines of an agreement were reached in the negotiations in New Delhi, the London talks will be concerned with the rate of release of balances till 1950, the rate of interest on the amount that will be blocked and arrangements for the release of amounts from the blocked balances for the amortisation of pensions and the purchase of British investments, as and when the Government of India decide that this is called for.

64. When the rupee was tied to the sterling standard, its value fluctuated in terms of other currencies, as the value of the sterling fluctuated in the international markets. This linking of the B.G. rupee with sterling was an obvious advantage; but, as the currency with which the link was maintained was one of the most important currencies of the world, the value of the B.G. rupee was reasonably stable and it was freely convertible into all the other currencies. Difficulty was, however, experienced when the sterling ceased to be freely convertible into other currencies since the outbreak of the war.

65. Sections 40 and 41 of the Reserve Bank of India Act, which have now been amended, formerly compelled the Reserve Bank to buy and sell sterling in B.G. rupee, at certain fixed rates, without limit of amount, thus making the rupee an independent currency. Though these provisions were designed, originally, only to maintain the external value of the rupee, they were used during the war to provide rupee finances required by the British Government. This use of the sections, which resulted in the creation of sterling balances, led to wide-spread

agitation for their removal. The effect of the amended provisions would be to de-link the rupee from sterling and link it with what might be described as an international standard.

66. In the International Monetary Fund, members are required to express the par values of their currencies in terms of gold, and exchange rates are determined by the ratios which the par values so expressed to member currencies bore to each other. The continuance of a direct statutory link with the sterling through Sections 40 and 41 of the Reserve Bank of India Act, now repealed, had, therefore, become both unnecessary and inappropriate. The replacement of the above Sections by a new Section is designed to link the B.G. rupee to currencies of those countries who are members of the International Monetary Fund. The Reserve Bank would, in future, have the power, under directions from Government, not only to buy and sell sterling, but other currencies as well; though, in practice, it would continue as before, to deal only in sterling till the foreign exchange position became clearer, as a result of settlement of sterling balances. Thereafter, it will begin operations in other currencies also.

67. Thus, the amendments to Sections 40 and 41 of the Reserve Bank of India Act, would not have the immediate effect either of changing the rupee-sterling rate or of taking India out of Sterling Area; but, as the Reserve Bank of India would have the power to buy and sell all currencies, including sterling, the exchange rate of the B.G. rupee in terms of sterling, which was hitherto fixed by the Reserve Bank, will, in future, be determined by the Central Government.

68. In the light of the above, it is suggested that Clauses 10 and 11 of Schedule II—Part 'A' of the Hyderabad State Bank Act, 1350 F., might be substituted by a single clause in the revised Act, as follows:—

Present Clause	*Revised Clause*
10. The Bank shall sell on Government account, out of the cash assets of the Currency Department, to any	The Bank shall sell to or buy from any person authorised by the Bank, who makes a demand in

person who makes a demand and pays the price in legal tender, British Government rupees, at the minimum rate fixed by Government from time to time, by notification in the Jarida.

11. The Bank shall buy on Government account, out of the cash assets of the Currency Department, from any person who makes a demand in that behalf, British Government rupees, at the maximum rate fixed by Government from time to time by notification in the Jarida.

that behalf at its office in Hyderabad, foreign exchange at such rates of exchange and on such conditions as the Government may from time to time by general or special order determine; provided that no person shall be entitled to demand to buy or sell foreign exchange of a value less than O.S. rupees ten thousand.

69. The above provision, as revised, would empower the Hyderabad State Bank, under directions from Government, to buy and sell not only B.G. but also other currencies; but, as in British India, in actual practice, the State Bank would continue, as before, to deal only in B.G. currency, within limits to be fixed by Government, from time to time, until the foreign exchange position becomes clearer, after the settlement of the constitutional issues in India.

70. The Government of India have resorted to nickel coinage on account of inadequate supply of silver in the market, the prevailing high price of silver and to make it possible to discharge the obligations resting on them to return in kind the large quantities of silver borrowed from U.S.A. From the metallurgical point of view, if the silver contents of the rupee are reduced beyond 50 per cent., the coin becomes brittle and breaks during the process of minting. On the other hand, nickel is amenable to different processes involved in the manufacture of coins and so capable of taking a clear impression of the die.

71. In view of the high price of silver and other considerations explained above, His Exalted Highness' Government have decided to replace $\frac{1}{2}$, $\frac{1}{4}$ and $\frac{1}{8}$ silver rupee by pure nickel coins, as in British India, and a separate

proposal to replace the Q-silver rupee by a nickel rupee is under consideration of Government. If the proposal is finally sanctioned, it would enable the Government to hold silver, so released, of the value of at least rupees five crores, in the Paper Currency Reserve, as a cover against note issue.

72. With the introduction of nickel rupee, the question would arise whether it is necessary to effect any change in the exchange ratio between the B.G. and the O.S. rupee. The weight and fineness of the O.S. rupee was fixed on the original standard coin of the Delhi Rulers and is not the result of any treaty or agreement with the Government of India. The standard rate of O.S. Rs. 116-10-8=B.G. Rs. 100-0-0 or O.S. Rs. 7=B.G. Rs. 6, was based on the intrinsic values of the two rupees which were as follows :

	Silver	Alloy	Weight
O.S. Rupee	81.81%	18.19%	172.5 grains
B.G. Rupee	91.6%	8.4%	180 grains

73. Early in 1940, the Government of India, with a view to discourage hoarding, reduced the silver content of the B.G. rupee from 165 grains to 90 grains, with the result that there was half silver and half alloy in their Q-silver rupee. This led to the hoarding of the O.S. rupee which contained more silver in proportion to the new B.G. rupee. The Hyderabad Coinage Act was, therefore, amended and arrangements were made to mint the new O.S. rupee, with silver content reduced in proportion to the B.G. rupee.

74. As the B.G. rupee with 91.6 per cent. silver and the O.S. rupee with 81.81 per cent. silver, were both reduced to 50 per cent. silver, the original parity between the two coins was changed from 116.67 per cent. to a little over 104.3 per cent. Thus, the so-called standard rate has been only nominal and it has been adhered to simply because the prices of commodities, etc., have been stabilised at that rate and any change at this stage would involve traders in heavy loss. Besides, a very large portion of our Reserves which are held in B.G. currency, would have to be revalued at the revised standard rate. It was with the same object in view that

during the last 20 years, efforts were made to stabilise exchange very near the standard rate or, what is nominally accepted as the standard rate. With the reduction in the intrinsic value of the rupee, our coins have become purely token coins and the question of exchange ratio, dependent on the intrinsic value of the metal in the coin, has lost its importance ; and, as long as the value of the O.S. rupee has remained fairly stable during the last twenty years, very near the standard rate, there appears to be no necessity to disturb that ratio to the detriment of trade and industry.

75. It is, therefore, suggested that the status quo should be maintained in this respect, in spite of the introduction of nickel rupee in British India ; and, until the constitutional position is clarified, no change should be made in the present standard of exchange between the Indian Rupee and the O.S. Rupee.

76. *Foreign Exchange Control.*—In view of the disruption of the internal economy of the various countries and the interruption of the established channels of trade during and after the war, there has been a considerable shortage of foreign exchange. Besides, the adherence of India to the International Monetary Fund has made it necessary for her to take measures to regulate transactions in foreign exchange. The Foreign Exchange Regulation Act, 1947, has, therefore, been passed to give the Government of India powers to continue to control transactions in foreign exchange, securities and gold.

77. The Political Department of the Government of India had suggested to H.E.H.'s Government in December, 1946, that the permanent legislation in India would entail, for its effective administration, the enactment of parallel legislation in Hyderabad. H.E.H.'s Government agreed to introduce parallel legislation on the understanding :—

(*a*) that the Hyderabad State Bank would act as the Agent of the Reserve Bank, in this matter, in the Hyderabad State.

(*b*) that the source of authority of the Reserve Bank of India in Hyderabad would be H.E.H. the Nizam's Government.

(c) that the foreign currency requirements of Hyderabad would be adequately met, not only through the normal trade balances of India, but also through the facilities available to India as a result of its membership of the International Monetary Fund.

78. No reply has been received from the Government of India in this connection and the decision in the matter would depend on the arrangements made by H.E.H.'s Government in matters of trade and finance with the Government or Governments in India. If definite trade and financial arrangements are made with the Governments in India, an independent Exchange Control could be operated by the Hyderabad State Bank, in consultation with H.E.H.'s Government, for all foreign currency dealings; but before this system could be introduced, it would be necessary for H.E.H.'s Government to negotiate with the Governments in India regarding the allocation of foreign exchange out of the foreign exchange resources of India as a whole, for the use of Hyderabad. Such an arrangement would enable H.E.H.'s Government to act as a final authority for all foreign currency dealings, although Hyderabad would be dependent for foreign exchange on the control set up by the Government of India by its own legislation.

79. On the other hand, if H.E.H.'s Government fails to enter into any definite trade and financial arrangements with the Governments in India, it must be prepared to make its own independent arrangements to secure foreign exchange, particularly in sterling and dollars, and, for that purpose, to obtain long-term credit in foreign countries for its immediate requirements, and thereafter to negotiate for membership of the International Monetary Fund.

80. The membership of the International Monetary Fund would give us the facility of borrowing hard currencies and paying back the debt not necessarily in the borrowed currency, but through the clearing arrangements of the Fund. Membership of the International Monetary Fund, however, does not mean that Hyderabad should necessarily remain out of the Sterling Area. Under the First Schedule to the British Exchange Control Act, 1947, which sets out 'the Scheduled territories' *i.e.*, the extent of the Sterling Area, Hyderabad would cease to be within the Sterling Area, no sooner its inde-

pendence becomes a fact, unless an amendment is made in that Act.

81. All these issues will have to be examined immediately after the constitutional matters are finally settled.

82. It would, however, be necessary to keep a draft of the Foreign Exchange Regulation Bill ready, on the lines of the Foreign Exchange Regulation Act, 1947, of the Government of India, so that the exchange control may be immediately enforced through the Hyderabad State Bank, after the constitutional position is definitely known.

CHAPTER VII

Functions of the Central Banking Department.

83. To enable the Bank to exercise its control over currency and credit, the Central Banking Department will be entrusted with the following powers usually possessed by central banks.

(1) The Bank will have the sole right to issue Bank notes in H.E.H. the Nizam's Dominions.

(2) The Bank will undertake to accept and hold monies for account of the Government and to make payments on behalf of the Government and to carry out exchange, remittance and other banking operations in respect of those monies.

(3) The Bank will also carry out the remittance, exchange and banking transactions on behalf of the Government, outside H.E.H. the Nizam's Dominions.

(4) The Bank will accept the custody and management of the various Reserves of the Government.

(5) The Bank will have the power to buy and sell B.G., Sterling and other foreign currencies and maintain the stability of the external value of the O.S. rupee in terms of other currencies.

(6) The Bank will also have the right to hold the cash balances of all commercial banks to be included in a separate Schedule to the Act. These scheduled banks will be required to maintain with the Bank a balance of not less than 5 per cent. of their demand liabilities and 2 per cent. of their time liabilities. It is, however, proposed that for the regulation and convenient adjustment of accounts between the member

banks and the State bank and the establishment of a Clearing House, this particular function should be entrusted to the General Banking Department.

84. Besides the essential central banking functions mentioned above, the Bank will be authorised to transact other business of a nature usually performed by central banks, such as :—

(1) the re-discounting of bills-of-exchange and Treasury Bills or documents of title to goods and making of loans and advances, under certain conditions, to the General Banking Department, and to other banks and credit institutions,

(2) fixing and publishing, from time to time, the minimum rate at which the Bank will re-discount bills-of-exchange, etc., as are mentioned in (1) above;

(3) establishing and maintaining, either directly or indirectly, contact with the monetary authorities established in other countries and opening of account or the making of agency agreements with banks which are the principal currency authorities of the countries concerned;

(4) supply of currency notes or Bank notes of lower value or other coins which are legal tender under the Hyderabad Currency Act, 1321 F., in such quantities as may be required for circulation, in exchange for currency notes or Bank notes of five rupees or upwards;

(5) buying, selling or otherwise dealing in foreign currency, specie, gold or other precious metals ;

(6) establishing credits and giving guarantees ;

(7) buying, holding or selling securities of Government or guaranteed by Government which have been offered for public subscription and are officially quoted on the Hyderabad Stock Exchange or securities of or guaranteed by the Government of any other country ;

(8) buying, holding or selling securities of any public authority which are authorised by law for the investment of trust funds and have been offered for public subscription or tender before being bought by the Bank and are officially quoted on the Hyderabad Stock Exchange.

(9) making provision for collection and study of data relating to monetary and credit problems and publishing informatory material in regard thereto.

85. The chapters that follow describe in greater detail the above-mentioned functions of the Bank in the manner in which they are to be carried out in practice.

CHAPTER VIII

Issue Department.

86. The issue of notes, as of other currency, was claimed to be a prerogative of the State; but, whereas in the case of metallic currency, the State retained its prerogative, it decided, with few exceptions, to hand over the issue of notes to banks. Banks were given the right to issue notes, or where banks had already put into circulation notes of their own, in one form or another, they were legally authorised to continue issuing notes, subject to certain safeguards imposed by law. In due course, as more banks came to be established in each country and currency notes came into greater use with rapid expansion of trade, the need for uniformity in the note circulation and for better regulation of the note issue, caused almost every country to introduce specific legislation, granting one bank a complete monopoly of the note issue. In all cases, however, the banks entrusted with the sole or residuary monopoly of note issue, were the recognised central banks of their respective countries; and this monopoly privilege was a primary factor in their development into central banks, with special duties and responsibilities of a semi-public character.

87. Every country found it necessary or desirable, not only to bring about uniformity in its note circulation according as notes became more and more the principal form of currency, but also to attain effective state supervision over a credit instrument which had, for the sake of convenience, to be declared by law to be legal tender money. Although this uniformity and state supervision could also have been achieved by means of a direct state issue, the many examples of depreciation of Government notes in the past and the consequent public distrust of Government issues, caused the State to concentrate the note issue in one bank, even if it was a State Bank. In other words, the Government considered it advisable, in the circumstances, to exercise their supervision over the note circulation, indirectly, through

a central bank governed by special legislation, rather than directly through a Government department.

88. As stated above, the Hyderabad State Bank has been already entrusted with the management of State currency, as agents for the Government, through its Currency Department which has been kept distinct from the Banking Department. The Government has, however, reserved the right to print currency notes and to issue them, as provided in the Hyderabad Paper Currency Act, 1327 F., and the assets of the Currency Department are not subject to any liability other than the liabilities of the Currency Department. The Currency Department is not authorised to issue Government currency notes to the Banking Department or to any other person, except in exchange for other currency notes or for such rupee coin, gold and silver bullion or securities, as are permitted by the Hyderabad Paper Currency Act, 1327 F., to form part of the Reserve Fund.

89. The assets of the Currency Department of the Bank are held in a separate Reserve, as provided by the Hyderabad Paper Currency Act, 1327 F., and the net income derived therefrom, less a fixed charge, to be agreed upon annually between the Government and the bank, is payable to the Government at the end of each half year. The liabilities of the Currency Department are an amount equal to the total of the amount of the currency notes issued by the Government.

90. It is a principle of sound currency organisation that the issuing authority should also be the authority responsible for the control of currency standards. The duties of a Central Bank of Issue, in regard to the maintenance of the currency standard, are such that it cannot hope to discharge them satisfactorily, if its control of the volume of the circulation was liable to be defeated by the action of others. The Issue Department's monopoly should, therefore, be emphasised by the inclusion in its charter of an explicit renunciation by the State of its power to issue notes. The banking and issuing functions should, however, be completely separated.

91. In the Hyderabad State Bank, a separate department will be maintained for the issue of Bank notes called the Issue Department, the assets of which would

be kept distinct from those of its other departments. In other words, the present position will be maintained with this difference that, whereas the Government currency notes were issued by the bank as agents for Government, the bank will now issue their own notes which will be recognised as the legal tender currency of the State under the Act.

92. From the day the authority for issue of bank notes is vested in the bank, the Hyderabad Paper Currency Act, 1327 F., will be repealed and the relative provisions, suitably amended, incorporated in the revised State Bank Act. The Issue Department of the Bank will then take over the liability for all the currency notes of the Government, for the time being in circulation, and also the gold and silver bullion, the Rupee coin and the Rupee securities of this Government and of the Government of India, to such aggregate amount as is equal to the liability so transferred.

93. Under Section 9 of the Paper Currency Act, 1327 F., the assets of the Issue Department can be held in the form of gold or silver coin, gold or silver bullion, or the securities of the Government of India or the securities of H.E.H.'s Government or the securities issued by H.E.H. the Nizam's State Railway, provided that the purchase-value of such securities do not exceed 60 to 70 per cent. of the total value of notes in circulation at any time.

94. It is suggested that, in view of the impending constitutional changes, the assets of the Issue Department, after its transfer to the Bank, should be held in the form of gold and silver coin, gold and silver bullion, Rupee securities and the securities of the United Kingdom and the U.S.A., to such aggregate amount as is not less than the total of the liabilities of the Issue Department. Of the total amount of the assets, not less than one-fourth should consist of gold and silver coin, gold and silver bullion and rupee, sterling and dollar deposits with any bank or banks approved by Government. For the purpose of evaluating the assets, gold and silver bullion and Government securities will be reckoned at market value, subject to annual adjustment of fluctuations in prices from the Securities Adjustment Reserve, and the Rupee coin and deposits at their face-value.

95. In a country where agriculture in any form plays an important part, it is essential that the currency should be easily expanded to meet the increased demand when the crops are being moved. The present procedure to meet the seasonal demands of O.S. currency against purchase of B.G. bills from the cash balance of the Currency Reserve, has worked satisfactorily and it is suggested that the same procedure should be continued. The corresponding amount in B.G. rupee will he held in the form of short deposits with any bank approved by Government.

96. There was a time when the Government of India maintained two separate Reserves, as in Hyderabad—a Gold Standard Reserve and a Paper Currency Reserve—the former meant for exchange maintenance, the latter for maintenance of convertibility of Note Issue ; but, with the establishment of the Reserve Bank of India, the two Reserves were amalgamated into one Reserve in the Issue Department. According to the arrangements at present existing in Hyderabad, the burden both of convertibility and exchange, is borne by the Paper Currency Reserve alone. The O.S. Stabilisation Reserve, which is really the Reserve meant for exchange regulation, is maintained intact at a fixed figure of O.S. Rs. 3 crores. As the Hyderabad Currency is fully backed by a Reserve in securities and B.G. and O.S. rupee coin, it is not necessary to amalgamate the O.S. Stabilisation Reserve with the Paper Currency Reserve, as was done in British India at the time of handing over the right of note issue to the Reserve Bank of India.

97. With the present abnormal rise in the prices of gold and silver and the introduction of nickel rupee in India, and the proposed introduction of a nickel rupee in Hyderabad, it will not be necessary to maintain a separate O.S. Stabilisation Reserve. It is suggested that securities of the value of Rs. 1,38,25,000 (Rupees one crore thirty-eight lakhs and twenty-five thousand) may be transferred from this Reserve to the Securities Adjustment Reserve, for meeting any depreciation in the market value of sterling and B.G. rupee securities and gold and silver bullion, from time to time. The balance of O S. Rs. 1,61,75,000 (Rupees one crore sixty-one lakhs, seventy-five thousand) may be utilised to make up the initial

working capital of Rs. 2 crores for the General Banking Department of the Bank, as suggested in paragraph 47 of Chapter V.

98. The Issue Department will be concerned with the issue of notes and the maintenance against them of statutory assets. The Bank notes will be legal tender for the amounts expressed therein and their repayment guaranteed by H.E.H. the Nizam's Government. In order to provide currency for the transactions of the Government and reasonable remittance facilities to the public, the Issue Department will maintain currency chests, containing both notes and rupee coin, at all branches of the Bank and all districts and a few important Tahsil Treasuries. The Issue Department will also maintain, on behalf of Government, a Small Coin Depot for supplying subsidiary coin to the public, in such quantities as are require for circulation. A separate Resource Section will attend to the supply of funds at different centres through the mechanism of the currency chests which have been or will be established at all branches of the Hyderabad State Bank, to carry out Government Treasury business, and at all District Treasuries and a few important Tahsil Treasuries.

99. As at present, a currency chest will consist both of notes and rupee coin. Notes held in the currency chest are not for circulation, while the rupee coin held in the chest will form part of the assets of the Issue Department. A deposit of notes in the currency chest thus means a reduction in the amount of notes in circulation, while a deposit of rupee coin into the chest means an increase in the amount of coin forming part of the reserve held against the notes in circulation. Similarly, the withdrawal of notes from a currency chest would mean an increase in the amount of notes in circulation, while the withdrawal of rupee coin from a currency chest would result in a reduction in the amount of coin forming part of the reserve held against the notes in circulation. A deposit of notes or coin into one currency chest thus enables the issue at another currency chest, of notes or coin up to the amount of the deposit, without the actual remittance of notes or coin and also without an actual change in the amount of coin held as part of the reserve against notes in circulation. A currency chest thus obviates the necessity for frequent remittances of notes and coin from one place to another.

100. By the use of Currency Chest, therefore, economy of metallic currency is promoted, currency operations facilitated and unnecessary movements of coin and notes avoided. However, if a Treasury is constantly and heavily in deficit, the currency chests will not be able to prevent an actual transfer of cash for all time. Remittances are also effected for removal of soiled and torn currency notes from the currency chests to the Exchange Branch of the Issue Department, for cancellation.

101. Expansion of currency can be effected by increasing any of the assets of the Issue Department and issuing equivalent notes from the Department. Similarly, contraction can be effected by withdrawing notes from circulation and reducing any of the assets, provided the statutory proportion between the securities and metallic portion of the Reserve is maintained. Ordinarily, in the case of expansion, the Bank will increase the assets of the Issue Department by transferring rupee or sterling securities and/or Treasury Bills from the General Banking Department to the Issue Department or by creation of ad hoc Treasury Bills by Government ; and in the case of contraction, the Bank will reduce the assets by transferring securities or Treasury Bills from the Issue to the Banking Department or by cancellation of ad hoc Treasury Bills held in the Issue Department.

102. Currency will be expanded or contracted by the Bank against deposit of ad hoc securities as a matter of policy. When the cash balance of Government with the Bank requires replenishment, the Bank will resort to expansion of currency and transfer notes from the Issue to the Central Banking Department, according to their requirements, subject to a maximum of 15 per cent. of the total amount of currency in circulation. Such a provision has been made in the existing Hyderabad State Bank Act (Vide Clause 7 (1) of Schedule II, Part A). When the Government will find its balance in excess of its normal requirements, it will reduce its debt obligation against cancellation of ad hoc Treasury Bills held in the Issue Department.

CHAPTER IX

Other Central Banking Functions.

103. *Public Accounts Department.*—This Department will maintain the accounts of Government and receive and disburse money on their behalf. The procedure for the receipt and disbursements on Government account and the manner in which Government accounts are to be kept and returns submitted to Government will be governed, as at present, by the Account Codes and the orders of the Controller-General. Classified statements of daily receipts and payments will continue to be submitted to the Controller-General. This Department will also collect cheques on behalf of Government and encash the interest warrants on Government securities. Government Treasury Bills will also be issued and repaid by this Department. In addition, the Department will also encash repayment orders relating to Government loans, etc.

104. *Securities Department.*—This Department will deal mainly with the purchase, safe custody and sale and collection of interest on securities held by local bodies and by Government officers in their official capacity. These securities will also include trust fund securities and other deposits administered by Government Officers. This Department will also act as the agent for handling the securities which the Insurance Companies will have to deposit with Government under the Hyderabad Insurance Act, 1356 F. In addition, the Department will also hold securities of the various reserves of Government

105. *Public Debt Office.*—The management of the public debt of H.E.H.'s Government and the maintenance of the relative accounts will be vested in the Public Debt Office which is at present managed on behalf of Government by the Hyderabad State Bank. The law relating to Government securities is contained in the Hyderabad Securities Act, 1330 F. and the procedure for dealing with the issue, conversion and renewal of securities and payment of interest, etc., on Government loans, is laid down in the Hyderabad Securities Manual, issued under the authority of Government. After the transfer of the Public Debt Office to the Central Banking Department

of the Hyderabad State Bank, it will be necessary to amend the Securities Act and the Manual referred to above, with a view to give full authority to the State Bank for the management of public debt, and disposal of claims, etc., in respect of Government securities.

106. The Government securities will be issued, as at present, by the Public Debt Office in the form of stock certificates and promissory notes. Promissory notes of any loan can be converted into stock certificates or *vice versa*. Interest on stock certificates is paid by warrants issued by the Public Debt Office without presentation of the stock certificates, at the time of either the issue of interest warrants or their encashment; but, in the case of promissory notes, presentation of the note itself at the Public Debt Office is indispensable.

107. The functions of the Public Debt Office are payment of half-yearly interest on Government securities, enfacement of securities for payment of interest at a District or Tahsil treasury, renewal, conversion, consolidation and subdivision of different kinds of Government securities, investigation of disputed cases and of claims relating to issue of duplicates of lost, stolen or destroyed securities and repayment of loans notified for redemption.

108. All new loans of H.E.H.'s Government will be floated by the Bank in the Public Debt Office and necessary arrangements made for the receipt of subscriptions at its Head Office in Hyderabad and its branches in the Districts and at District and Tahsil treasuries, on terms to be notified by Government in consultation with the Bank.

109. *Treasurer's Department.*—The cash balances of the Issue Department and the Public Accounts Department will be maintained in two separate sections, and will be in charge of a Treasurer. The Issue Branch of the former section will be mainly concerned with the receipt, safe custody, examination and issue of fresh notes to the Exchange Branch and the currency chests. The Exchange Branch will deal with the exchange of notes and coin of various denomination tendered for exchange by the banks and the public, the examination of note remittances, the receipt and examination of coin

remittances from currency chests and treasuries and the sorting and listing of defaced notes. This Branch will also keep the initial accounts of the assets of the Issue Department and of the various balances held in its custody.

110. Cash balances of Government will be separately maintained by the Treasurer and all receipts and disbursements made, on behalf of Government, on the authority of the Public Accounts Department.

111. *Exchange Control Section.*—As stated in Chapter VI, the Central Banking Department will be entrusted with the duty of maintaining the stability of the external value of O.S. rupee and, for this purpose, it will be required to sell and buy B.G. rupees, within certain limits fixed by Government, until such time as constitutional changes necessitate dealing in all foreign currencies. In the latter case, the Central Banking Department will have to constitute a separate Exchange Control Section to deal with the work relating to the control of dealings in coins, bullion, securities and foreign exchange, according to the powers vested in them under the Act.

Department of Banking Operations, Law, Research and Statistics.

112. With a view to providing the administrative machinery that would be necessary to undertake the several duties and responsibilities, especially in the matter of receiving returns from banks, inspection and liquidation, a separate department will have to be organised. This Department will deal with all problems relating to the scheduled and non-scheduled banks, such as fixing credit limits for the scheduled banks, carrying out, on behalf of Government, inspection of banks, studying the balance sheets and other returns submitted by banking companies, rendering advice on banking and financial matters to banks and Government and also on banking legislation, etc.

113. After the revised Hyderabad State Bank Act is passed, the State Bank will immediately draft a Bill to consolidate and amend the law relating to banking companies in Hyderabad, on the lines of the Bill recently introduced in the Indian Legislative Assembly. In this

Banking Companies Bill, provision will be made for the inspection of the affairs of the banking companies operating within the Dominions, by the Hyderabad State Bank, under directions from Government. At present the Government have power to inspect banking companies under the Banking Companies (Inspection) Regulation, which has been drafted on the lines of the Inspection Ordinance of the Government of India. It is, therefore, suggested that until the Banking Companies Act is passed, the Banking Companies (Inspection) Regulation should continue to be in force and the Managing Director of the Hyderabad State Bank, under the revised Act, appointed the Inspecting Officer under Clause 3 (*b*) of the Inspection Regulation. Under Clause 3 (*a*) of the same Regulation the Reserve Bank of India has been appointed the inspecting authority in respect of banks scheduled under the Reserve Bank of India Act and operating within the Dominions. But when the Banking Companies Act is passed, the Hyderabad State Bank, as constituted under the revised State Bank Act, will be appointed the inspecting authority in respect of all banks operating within the Dominions.

114. The Statistical Section will compile the Bank's statistical summary and will also act as an agency for collection and dissemination of financial information and statistics. This Department will also prepare and transmit to the Finance Department, a monthly account of its Issue Department which will be published by them in the Jareeda. It will also publish, every month, a consolidated statement of returns received from the scheduled banks and issue Press Communiques regarding sales of Treasury Bills, figures of Clearing House, Government loans, etc. It will also undertake compilation of the Annual Report on Currency and Finance and the publication of statistical tables relating to banks in Hyderabad. It will also publish a quarterly statistical summary and submit to the Finance Department an Annual Report of the General Council.

CHAPTER X

THE BANK RATE AND ITS INFLUENCE ON THE MONEY MARKET.

115. The statutes of a number of central banks contain a provision to the effect that they must fix and publish the minimum or standard rate at which they will discount eligible bills-of-exchange, or grant advances against Government or Municipal securities, or gold and silver bullion, or against discount of Treasury Bills. Separate rates are often published for discounts and advances to commercial banks, as distinguished from the general public.

116. The significance of discount rates of central banks has been of a three-fold nature. In the first place, the official discount rate indicates the rates at which the public should be able to obtain accommodation on the specified types of paper from the commercial banks as well as the Central Bank. Secondly, where separate rates for the commercial banks are not published, the discount or bank rate represents the basis of the rates at which they can obtain Central Bank credit. Thirdly, the psychological value of the discount rate is of importance to the Central Bank as an instrument of credit control. It is at least a reflection of its opinion of the credit situation and sometimes of the economic position generally. The Central Bank can more readily create easy money conditions by declaring its willingness to deal directly with the public at low rates, than it can bring about dear money, simply by raising its rates and curtailing credit facilities to its own customers.

117. Although the present day conditions do not afford much scope for independent discount rate, there is good reason to believe that the official discount rate has nevertheless a useful function to perform, in conjunction with other measures of control, specially in a place like Hyderabad, where the Central Bank, in the absence of a Gold Reserve, cannot rely on the actual outflow or inflow of gold as its principal guide to credit policy. The Central Bank must maintain continuous observation of all the factors bearing on the business situation and speculative activity and exercise its personal discretion in the light of past experience and with the aid of statistical studies.

118. With the above object in view, in Chapter VII, dealing with the functions of the Central Banking Department, provision has been made for the State Bank to fix and publish, from time to time, the minimum rate at which the Bank will re-discount, on behalf of commercial banks and approved customers, bills-of-exchange, Treasury Bills and grant advances against Government securities and documents of title to goods, etc.

CHAPTER XI

General Banking Department.

119. The General Banking Department of the Bank will be authorised to carry on and transact the several kinds of business specified in Part 'B' of Schedule II, Chapter I, of the Hyderabad State Bank Act, 1350 F., but, after the transfer of the right of note issue to the Hyderabad State Bank, the General Banking Department will not—

(1) receive money on deposits with interest from banks and other persons, except at offices situated outside the Dominions;

(2) make any loan or advance for a longer period than twelve months, except on the guarantee of Government;

(3) purchase shares of any other bank or any company with limited liability, or grant loans upon the security of any such shares, except when they are deposited as collateral security; and

(4) advance money on mortgage of, or otherwise on the security of, immovable property or documents of title relating thereto, or become the owner of immovable property, except so far as is necessary for its own business premises and residences for its officers and servants.

120. Loans or advances may be granted, under special circumstances, on the securities mentioned under (3) and (4) above, on the guarantee of Government.

121. The present limits of exchange within which the Hyderabad State Bank could buy and sell B.G. currency under Clauses (10) and (11) of Schedule II—Part 'A' of the Hyderabad State Bank Act, are Rs. 116 and Rs. 117 for

B.G. Rs. 100, respectively; but ever since the present limits were fixed in 1351 F., the maximum and minimum limits have never been reached. The exchange has always fluctuated within a much narrower range and very near the standard rate. With a view to make the exchange control more effective, it is suggested that the minimum and maximum limits of exchange should be further narrowed down to Rs. 116-8-0 and Rs. 116-12-0, respectively.

122. The General Banking Department will continue to control exchange within the limits fixed by Government and obtain the required O.S. currency from the Exchange Branch of the Issue Department against deposit of B.G. rupees or any other form of security or securities permitted to be held in the Paper Currency Reserve under the revised Hyderabad State Bank Act.

123. After the transfer of the Issue Department, the Hyderabad State Bank will be allowed to discount demand bills or hundis from :—

(*i*) scheduled banks ; and

(*ii*) non-scheduled banks, indigenous bankers, companies, firms or individuals, approved by the Council of Administration.

124. The above arrangement will not only enable the Hyderabad State Bank to carry out this important function on sound lines, but also to avoid unhealthy competition by placing the Bank in the position of a bankers' bank.

125. In addition to the commercial banking functions referred to above, the General Banking Department will be entrusted with the right to hold the cash balances of all commercial banks which will be included in a separate schedule to the Act. This is primarily a function of the Central Banking Department, but for the convenient adjustment of accounts between the member banks and the State Bank and the establishment of a Clearing House, this particular function is proposed to be entrusted to the General Banking Department.

126. *Scheduled and non-Scheduled Banks.*— In all countries, the Central Bank has become the custodian of the cash reserves of the commercial banks by a process of

evolution which is closely associated with its functions as a Bank of Issue and Banker to Government. The centralisation of cash reserves in the Central Bank is an important factor in the monetary and banking structure of a country.

127. Since the inauguration of the Reserve Bank of India, the Joint Stock Banks have come to be divided into two main classes; namely, scheduled banks and non-scheduled banks. The scheduled banks, which may be compared to ' member banks ' in other countries, are those which are included in the Second Schedule to the Reserve Bank of India Act, while the non-scheduled banks are those which are not so included. The conditions which a Bank must fulfil in order to be classed as a Scheduled Bank are laid down in Section 42 (6) of the Reserve Bank of India Act. This Section provides that the Central Government shall, by notification in the Gazette of India, direct the inclusion in the Second Schedule of any bank not already so included which carries on business of banking in British India and which—

(1) has a paid-up capital and reserves of an aggregate value of not less than rupees five lakhs, and

(2) is a company as defined in Clause (2) of Section (2) of the Indian Companies Act, 1913, or a Corporation or a Company incorporated by or under any law in force in any place outside British India.

128. Similar procedure is proposed to be followed under the revised Hyderabad State Bank Act, except that the minimum limit of paid-up capital and reserves will be reduced from rupees five lakhs to rupees one lakh. If the value of the capital and reserves of any bank falls below the prescribed minimum, or if it goes into liquidation or otherwise ceases to carry on banking business, it will be liable to be excluded from the Second Schedule.

129. The scheduled banks will be required to maintain with the State Bank a balance not less than 5 per cent. of their demand liabilities and 2 per cent. of their time liabilities. The banks scheduled under the Reserve Bank of India Act and having their branches within the Dominions, will not be required to maintain the statutory deposits with the Hyderabad State Bank, provided

reciprocal arrangements are made with the Reserve Bank of India in respect of the banks registered in Hyderabad and having branches outside the Dominions. The best arrangement would be for the Reserve Bank of India and the Hyderabad State Bank to claim statutory deposits from banks, only in respect of demand and time liabilities within their respective territories.

130. The real purpose of the scheduled banks maintaining these balances with the State Bank is not to guarantee the deposits of the public with the scheduled banks; for, if this were so, a reserve of five per cent. against demand liability and two per cent. against time liabilities would hardly be adequate for the purpose. The primary object of these reserves is to enable the State Bank to exercise some measure of control over the banking system of the State.

131. Every scheduled bank will be required to send to the Department of Banking Operations of the Bank, a weekly return of its position, in the form to be prescribed under the Act. From the weekly returns, the Department will prepare and publish a consolidated statement, as required under the Act, which will provide a useful guide to the prevailing money conditions in the country.

132. The most important facility which the scheduled banks enjoy is that of financial accommodation in the shape of re-discount of bills or loans and advances against eligible securities from the State Bank. The State Bank will be empowered by the Act to grant only temporary accommodation; but it can be safely said that scheduled banks which are run on sound lines, can always expect and receive ready assistance from the State Bank, in times of emergency or stringency, subject to their offering suitable security. The various kinds of securities against which the State Bank can grant loans and advances to scheduled banks will be specified in the revised Act of the Hyderabad State Bank.

133. The scheduled banks will be granted special facilities for the remittance of money within the Dominions. A scheduled bank will be entitled to remit money by mail or telegraphic transfers between the accounts kept by its branches, sub-branches and pay-offices, at a branch or sub-office of the Hyderabad State Bank, as

follows :—

(*a*) An amount up to O.S. Rs. 10,000 between its accounts at the branches and sub-branches of the Hyderabad State Bank, within the Dominions, free of charge.

(*b*) Other remittances between its accounts at the branches and sub-branches of the Hyderabad State Bank, within the Dominions, in excess of O.S. Rs. 5,000, at 1/64 per cent., subject to a minimum charge of Re 1.

(*c*) If telegraphic transfers and drafts are issued in favour of third parties, at 1/16 per cent. up to O.S. Rs. 5,000 and at 1/32 per cent. over O.S. Rs. 5,000.

134. *Clearing House.*—An important power which will be conferred on the Hyderabad State Bank under the Act, will be that of regulating a Clearing House for the scheduled banks in Hyderabad. Rules will be framed for the purpose and a Clearing House established immediately after the revised Act of the Hyderabad State Bank is brought into force. The rules will specify the hours at which clearing shall take place, the manner of settling the credit and debit balances between the member banks, the manner of dealing with dishonoured cheques, etc.

CHAPTER XII

Industrial Finance Department.

135. The question of adapting modern banking to give assistance to industries, particularly small industries, outside the ambit of ordinary banking practice, has received consideration in other parts of the world, notably Great Britain and Canada, and special provisions have been made in those countries to meet the expected needs of industries in the post-war period.

136. Some similar provision is required in Hyderabad where capital has been generally confined to a few simple and safe industries of an obviously attractive nature, while minor industries have been almost entirely neglected, partly through ignorance of the country's resources in raw materials, but mainly because commercial firms have prospered too well, along conservative and stereotyped lines, to trouble about undeveloped industries with uncertain prospects.

137. The provision for credit for medium and long term capital requirmeents of an industry, falls outside the normal activities of commercial banks and, in certain cases, the usual methods of capital issue are not wholly practicable or suitable. There is thus a lack of facilities for providing long term capital for small scale industries.

138. It is, therefore, proposed to expand the activities of the Hyderabad State Bank by the creation of a separate Industrial Finance Department, in order to bridge the gap in the existing facilities and by taking over from the Government, business, assets and liabilities of the Industrial Trust Fund, which is under the direct management of the three Trustees appointed by Government.

139. It is not intended that the Industrial Finance Department would assist an industrial undertaking, without proper investigation. It would be necessary for the undertaking to have reasonable prospects of continuing to be, or of becoming, a profitable undertaking, before it would be assisted. The Industrial Finance Department of the Bank would, therefore, be empowered to lend money to establish and develop such undertakings. It would also extend assistance to an undertaking by direct investment in the shares and securities of that undertaking.

140. The new Department would require specialised knowledge, apart from ordinary banking, and there is every reason to hope that by running the Industrial Finance Department on modern banking lines, under appropriate management, it would render valuable service in the industrial development of Hyderabad.

141. The Industrial Finance Department, when organised, would take over from the Trustees, the business, assets and liabilities of the Industrial Trust Fund and would keep the accounts and transactions of the department separate and distinct from the other accounts and transactions of the bank.

142. The capital of the Industrial Finance Department would be the capital of the Industrial Trust Fund immediately prior to the transfer of the business, assets and liabilites of the fund to the bank. After making

provision for bad and doubtful debts and working expenses, including depreciation of assets, contribution to staff and superannuation fund, and such other contingencies as are usually provided for by bankers, the profits of the Industrial Finance Department would also be transferred to the capital of the Department. Provision would also be made, under the revised State Bank Act, for the Industrial Finance Department to take advances from the Government or the General Banking Department of the Bank, of such amounts and subject to such terms and conditions as are agreed upon between the Industrial Finance Department and the Government or the General Banking Department, as the case may be.

143. The functions of the Industrial Finance Department would be —

(1) to provide finance for the establishment and development of industrial undertakings, particularly small undertakings ;

(2) to assist in the establishment and development of industrial undertakings ; and

(3) to provide advice on the operations of the industrial undertakings, with a view to promoting the efficient organisation and conduct thereof.

144. The Industrial Finance Department would have also the power—

(1) to guarantee loans raised by industrial concerns in the public market ;

(2) to underwrite the issue of stock, bonds or debentures by industrial concerns ;

(3) to purchase or otherwise acquire shares and securities and sell or otherwise dispose of shares and securities so purchased or acquired ;

(4) to retain, as part of its assets, any stock, funds or debentures, which it may have to take up in fulfilment of its underwriting liabilities ;

(5) to grant loans or advances to, or subscribe to debentures of, industrial concerns, repayable within a period not exceeding 20 years from the date on which they are granted or subscribed to, as the case may be ;

(6) act as Managing Agents of the industrial concerns of which the Industrial Trust Fund were the

Managing Agents immediately prior to the transfer of its business, assets and liabilities to the Bank.

145. It is understood that all accommodation given by the Industrial Finance Department would be secured by a sufficient pledge, mortgage, hypothecation or assignment of Government or other securities, stocks, shares, or secured debentures, bullion, movable or immovable property or other tangible assets. The Industrial Finance Department would be given powers to impose on the industrial concerns, such conditions as it might think necessary or expedient, for protecting the interests of the Industrial Finance Department and securing that the accommodation granted by it is put to the best use by the industrial concern.

146. Provision will also be made in the Act to give the Industrial Finance Department the necessary right to protect its interest, in case of default, including the sale and realisation of the security pledged, mortgaged, hypothecated or assigned to the Department. The Department would also be given the power to call for repayment within the agreed period, if any industrial concern failed to comply with the terms of its contract with the Department in the matter of any loan or advance.

147. It has not been considered necessary to describe the detailed working of this Department, as it is proposed to be organised at a later stage.

CHAPTER XIII

Land Mortgage Bank Department.

148. The co-operative credit societies are not suited to the supply of long-term credit to the agriculturists for the purchase of land or costly agricultural appliances, the improvement of holdings, the repayment of past debt, and the redemption of mortgaged land. Commercial banks and indigenous bankers also cannot supply such credit, because they cannot afford to lock up their capital for long periods or to recover their loans in small amounts out of the earnings of the borrowers. Such credit can be supplied only by a special type of credit institutions, known as land mortgage banks,

149. The land mortgage banks in the Punjab, Madras, Bombay, Assam, Bengal and the Central Provinces, which are partly financed by Government, have all been registered under the Co-operative Societies Act. Strictly speaking, they are semi-co-operative in character, as they are limited liability associations of agricultural borrowers, with a few non-borrowers for obtaining initial capital and the business capacity that is necessary for efficient management. In some cases, members have contributed to the share capital a certain percentage of their borrowings, but generally the shareholding of each member is limited, and he has a single vote, irrespective of the number of shares held by him. Dividends are restricted and the aim is gradually to eliminate the non-borrowing members. The work of these banks, however, lacks the personal and human elements which are the main features of co-operation and the insistence is, not on the members' mutual knowledge of, or control over one another, but on the business capacity of the management for the purposes of the correct valuation of security, careful enquiries into titles to land, and the correct determination of the credit and repaying capacity of the borrowers.

150. The working capital of these banks consists of share capital, deposits and debentures which have been issued in some cases by themselves, in other cases by the provincial co-operative banks for their benefit, with a floating charge on mortgages of land, and the interest of which is guaranteed, or a portion of which has been purchased, by Government in some cases. In Madras, as it was found that the issues of different debentures by a number of independent banks hampered their successful floatation, a Central Land Mortgage Bank has been established to finance primary land mortgage banks by a centralised debenture issue.

151. Loans are given to members on the mortgages of their lands up to fifty per cent. of their value in some provinces, or up to thirty times the land revenue payable in others, after assessing the value of the lands, and determining the members' title to them, their right to alienate their need for the loans and their repaying capacity. A maximum has been laid down for the total amount that can be lent in this way to individual members. The period of the loans varies up to a maximum of

16, 20 or 30 years in different provinces, and the rate of interest charged is from six per cent. to even eight and nine per cent.

152. Personally, I do not see any special advantage in making land mortgage credit available to agriculturists through co-operative institutions, because all attempts to combine saving and borrowing by compelling borrowers to subscribe to the share capital a portion of the loans obtained by them, are futile. The average agriculturist would not understand their rights and duties as shareholders in respect of helping and watching the banks to maintain solvency 'and to increase in strength. The directors who are elected by shareholders and who are also borrowers in a majority of cases, would find it very difficult to be strict in insisting on the regular repayment of instalments of loans by the latter.

153. It is, therefore, suggested that Government should take direct interest in providing long-term finance to agriculturists; and, in the interest of economy and efficiency, land mortgage credit should be made available in a separate Land Mortgage Department of the Hyderabad State Bank, and the Land Mortgage Bank Act, 1349 F., repealed. The working capital should be obtained mainly by the issue of debentures which should be guaranteed by Government, both as regards principal and interest. The risk of guaranteeing the debentures would be small, as the land, on the security of which loans would be given by the Bank, would be carefully valued through the agency of the Revenue Department (Rural Reconstruction Department), who would recommend the loan only after scrutinising the position of the borrower, the amount of the loans and the value of the security offered. For granting loans and receiving the loan instalments, etc., arrangements would be made at the Bank's branches and with the Co-operative Credit Societies Department, under a separate agreement.

154. The accounts and transactions of the Land Mortgage Department, when organised, would be kept separate and distinct from the accounts and transactions of the other departments of the bank.

155. In addition to the power to raise capital by

issue of debentures, this department would have the authority to take advance from Government, of such amounts and subject to such terms and conditions as are agreed upon between the Government and the Bank. The Central Banking Department would also give assistance to this department for such amount and subject to such terms and conditions as the Council of Administration, with the approval of the General Council, may determine.

156. Loans would be made by this department to any person engaged in farming, agricultural, horticultural, pastoral or grazing operations, or in such other form of primary production as the Bank thinks fit, upon the security of a mortgage to the Bank of an estate or interest in land in H.E.H. the Nizam's Dominions owned by the borrower, where the land is used or is to be used primarily for farming, agricultural, horticultural, pastoral or grazing operations, or in such other form of primary production as the Bank thinks fit. A loan would not be made by this department upon the security of a mortgage of any estate or interest in land which is subject to a prior mortgage or charge (other than a mortgage to the Bank to secure a loan or a statutory charge to the Government), unless the prior mortgage or charge is discharged out of the money lent or otherwise. Except to the extent that any money lent is used to discharge a prior mortgage or charge, any money so lent, shall be used by the borrower in connection with the various forms of primary production mentioned above, and where any money so lent is not used for any such purpose, the money lent, together with interest on the money, would, at the option of the bank, become due and payable on demand; and, after the exercise of the option, interest would accrue from day to day.

157. A loan would not be made by the Bank for a period of less than five years or more than twenty years. The amount of any loan, or if there are two or more such loans, to any one person or to persons jointly, the aggregate amount of these loans, would not exceed fifty per cent. of the value (as determined by the Bank) of the estate or interest in land on which the loan or loans are secured. The Bank would make loans on such terms and conditions as the Council of Administration may determine.

158. It has not been considered necessary to describe the detailed working of this department, specially as regards the scrutiny of the proposals through Government agency or agencies and the disbursement and recovery of loans in the districts, as the department is proposed to be organised at a later stage ; but in the relative draft bill provision has been made to authorise the bank to enter into agreement for that purpose with the department or departments of Government.

CHAPTER XIV

Bank Service—Pension and Provident Fund Rules.

159. The Hyderabad State Bank have framed their own Service Rules, both for the supervising and clerical staff and Pension and Provident Fund Rules, with the sanction of the Board of Directors and the Government. After the conversion of the Hyderabad State Bank into a State-owned institution, these rules, with such alterations as may be considered necessary, will continue to apply to officers and clerical staff of the Bank.

160. At the time of the transfer of the Currency Department, the Public Debt Office and the Government Treasury work to the Bank, the services of the employees working in these departments were taken over from the office of the Controller-General and the Central and District Treasuries. In respect of these employees, it was arranged that they would continue to be in the service of the Government for the first three financial years, when a final agreement would be entered into for their absorption in the permanent service of the Bank. As the scales of salaries of Bank employees are more favourable than the existing scales of Government employees transferred to the Bank, there is considerable dissatisfaction among the latter employees. The three years' period will expire on the 30th Aban, 1356 F. It is, therefore, suggested that those Government employees whose services are proposed to be retained by the Bank, should be permanently transferred to the Bank, and the Bank's rules in the matter of leave made applicable to them. They may, however, be given the option either to be governed by the Bank rules or by the Government rules in the matter of pay, allowances and pension. Those

Government servants who accept service under the Bank rules, will be fixed up in the Bank scales of pay and allowances, with effect from 1st Azur, 1357 F., or from the date the revised State Bank Act comes into force, whichever is earlier.

161. Further details regarding pension contribution, etc., in respect of transferred personnel would be settled in consultation with the Controller-General.

CHAPTER XV

Bank's Premises.

162. The Government building at present occupied by the Hyderabad State Bank, is not large enough to accommodate the combined activities of the Hyderabad State Bank, after taking over the central banking functions, including the right of note issue. It may be necessary, at a later stage, to construct a new building for the Bank, but until that is made possible, it is suggested that certain extensions and alterations may be carried out immediately in the existing building, in consultation with the P. W. Department.

CHAPTER XVI

Conclusion.

At the present time when Hyderabad is facing a future which is full of problems and momentous economic issues, any legislation affecting the banking system is of vital national importance. A banking system must always be in the process of evolution, continuously adapting itself to changing conditions. It has come to be recognised throughout the world that changes in the banking system should be the result of conscious decisions of policy.

The legislation which has been proposed in this report, is based on the conviction that the Government must accept responsibility for the economic condition of the country. The problems of the post-war period, of employment, of development and of trade, are of such magnitude, and involve such serious consequences, that no other attitude could be maintained. It has, therefore,

been recommended that, with a view to maintain the economic prosperity of the country, the Government should assume the powers which are necessary over banking policy.

The draft Bill has been designed to meet the changing conditions in Hyderabad and to provide the Hyderabad State Bank, as bankers' bank, with adequate powers to serve the interests of the country. It is hoped that, if the recommendations in the report are accepted, and the Bill passed into an Act, the Hyderabad State Bank would develop as one of the principal agents of national stability and progress.

(Sd.) C. B. TARAPORVALA,
9-11-56 F.

ANNEXURE 'A'.

EXPLANATORY MEMORANDUM.

Hyderabad is the only State in India which has its own metallic as well as paper currency. The issue of metallic currency is governed by the Hyderabad Paper Currency Act of 1321 F. and the issue and regulation of paper currency by the Hyderabad Paper Currency Act of 1327 F. The weight and fineness of the Hyderabad Rupee (which weighs 172.5 grs. against the corresponding B.G. Rupee coin of 180 grs.) was fixed on the original standard coin of the Delhi Rulers and is not the result of any treaty or agreement with the Government of India. The standard rate of O.S. Rs. 116-10-8=B.G. Rs. 100 or O.S. Rs. 7=B.G. Rs. 6 was originally based on the intrinsic values of the two rupees, which were as follows:—

Particulars			*Silver*	*Alloy*	*Weight*
			Per cent.	Per cent.	Grs.
O.S. Rupee	..	..	81.81	18.19	172.5
B.G. Rupee	..	..	91.6	8.4	180.0

2. Early in 1940, the Government of India reduced the silver content of the B.G. rupee from 165 grs. to 90 grs. This led to the hoarding of O.S. rupee which contained more silver in proportion to the new B.G. rupee. Action had to be taken, therefore, to amend the Hyderabad Coinage Act and to mint the new rupee with silver content reduced in proportion to the B.G. rupee.

3. As the B.G. rupee with 91.6 per cent. silver and O.S. rupee with 81.81 per cent. silver, were both reduced to 50 per cent. silver, the original parity between the two coins was changed from 116.67 per cent. to little over 104.3 per cent. Thus, the so-called standard rate is only nominal and it has been adhered to, simply because the prices of commodities, etc., have been stabilised at that rate. With the reduction in the intrinsic value of the rupee, both the B.G. and the O.S. rupee coins have assumed the nature of token coins and the question of exchange ratio, dependent on the intrinsic value of the metal in the coins, has lost its importance.

4. Hyderabad Paper Currency is fully backed by a separate reserve in silver coin and in Government of India securities. Section 9 of the Act, as amended in 1352 F., provides that not more than 60 to 70 per cent. of the total value of currency notes in circulation may, in lieu of cash, be kept in securities of the Government of India or of this Government. The Paper Currency in circulation at the end of 31st March 1947, stood at O.S. Rs. 5,131.26 lakhs, against which securities of the Government of India of the value of O.S. Rs. 2,949.33

lakhs were held in the Paper Currency Reserve and the balance in O.S. and B.G. rupees.

5. From 1850 up to the end of the nineteenth century, efforts were repeatedly made by the Government of India to introduce the B.G. rupee in Hyderabad as legal tender currency of the State or, at least, to have a coin of the same weight and value throughout India. Each time H.E.H.'s Government took a very firm attitude and pointed out that the right of coinage is an inestimable privilege for Hyderabad —" a precious heirloom prized by the Ruler and subjects alike." Whether Hyderabad declares its independence or not, the right of coinage is such a valuable asset that it would never agree to surrender the same voluntarily, or even to have a uniform coinage of the same weight and value as in the other parts of India. That is considered to be the only way to preserve the identity aud prestige of the Hyderabad Rupee against the currency of their much stronger neighbours.

6. The question of linking the Hyderabad Rupee with the Sterling or with the currency or currencies of the future Indian Governments, would be considered in due course; but, at this stage, when the entire constitutional position is so uncertain, H.E.H.'s Government is not in favour of definitely shaping their policy, specially in respect of their currency. They have, therefore, decided not to make any changes in their present currency policy in spite of the introduction of the nickel rupee in British India and the amendment of Sections 40 and 41 of the Reserve Bank of India Act. Until the political situation is clarified, they do not propose to make any change in the present standard of exchange between the B.G. and the O.S. rupee.

7. In view, however, of the impending constitutional changes, H.E.H.'s Government have decided to separate the currency authority which has been vested in the Finance Department, by the creation of a Central Bank of Issue and by vesting in it the functions of a Bankers' Bank. The Hyderabad State Bank, which is mainly a commercial Bank, has, up to now, been performing certain central banking functions. This combination cannot be allowed to continue except in the initial stages of its development.

8. The Hyderabad State Bank was started, with a view to provide credit necessary for the economic life of the country and to encourage the growth of agriculture, commerce and industries, within the Dominions, in close relation with H.E.H.'s Government. Great care was, therefore, taken to see that the Bank was not a mere duplication of the existing commercial banks or other credit institutions functioning in competition with them. The idea on the contrary was that the Bank would fill in the gaps in the credit structure wherever they exist and offer additional stimulus to the existing institutions by giving a fillip to industries and agriculture, as far as possible.

9. The Hyderabad State Bank has been established as a shareholders' bank and, as it has been entrusted with the management of Currency, Public Debt and also with all treasury and banking transactions of Government, H.E.H.'s Government have retained certain powers to control the affairs and management of the Bank. The Managing Director of the Bank is appointed with the approval of

Government. If the Bank fails to carry out any of the obligations imposed on it by the Hyderabad State Bank Act, the Government has the power to declare the Board of Directors superseded and, thereafter, to take any action it may deem necessary. To avoid such a catastrophe and to exercise full control over the Bank's management, the Government holds, at all times, shares of the face value of 51 per cent. of the share capital issued by the Bank. Under Section 61 of the Hyderabad State Bank Act, the Government has the right to nominate the President and three Directors of the Board in addition to the Managing Director.

10. The issue of all currency notes is conducted by the Bank, *as agents for the Government,* in a Currency Department, which is kept wholly distinct from the Banking Department. The Government have retained the sole right to print currency notes for circulation within the Dominions, as provided in the Hyderabad Paper Currency Act of 1327 F. The assets of the Currency Department are not subject to any liability, other than the liabilities of the Currency Department. The Currency Department cannot issue currency notes to the Banking Department except in exchange for other currency notes or for such coin, bullion or securities as are permitted by the Hyderabad Paper Currency Act of 1327 F. to form part of the Reserve. The assets of the Currency Department are held in a separate reserve as provided by the Hyderabad Paper Currency Act of 1327 F. and the net income derived therefrom, less a fixed charge, is paid to the Government. The liabilities of the Currency Department are always equal to the total amount of currency notes of the Government for the time being in circulation. According to a recent amendment in the Act, the One Rupee Currency Notes are treated as coin and their issue is not backed by a Reserve.

11. All rupee coins are placed in circulation through the Hyderabad State Bank and the Bank has undertaken not to dispose of rupee coin, otherwise than for the purposes of circulation or by delivery through the Government for any purpose provided in the Hyderabad Currency Act of 1321 F. The Government is under an obligation to supply coins and currency notes to the Bank on demand and the Bank is under a similar obligation to supply different forms of currency to the public.

12. Out of an authorised capital of Rs. 1½ crores, only Rs. 75 lakhs have been issued, divided into fully paid shares of Rs. 100 each, the maximum holding by any individual, either jointly or severally, has been limited to 200 shares; but the Government has reserved the right to hold at all times shares of the face value of not less than 51 per cent. of the share capital issued by the Bank. The Government have deposited with the Bank all their cash balances and have entrusted them with—

(1) their remittance, exchange and banking transactions.
(2) the custody and management of the various reserves, including the Paper Currency Reserve.
(3) the management of the Public Debt, and
(4) the issue of all currency notes and coins, as *agents for the Government.*

13. The value of Hyderabad Currency in relation to the B.G. Rupee is at present maintained between the fixed limits of exchange, namely, O.S. Rs. 116 and Rs. 117 for B.G. Rs. 100. The Hyderabad State Bank has been placed under an obligation to buy and sell B.G rupee at the maximum and minimum rates fixed by the Government from time to time. This procedure enables the Bank to control the transactions in exchange within the limits laid down by the Government.

14. The several kinds of business which the bank is authorised to carry on and transact has been specified in a separate schedule of the Act. The bank is authorised to advance and lend money and open cash credits not only against gilt-edged securities, but also on the security of—

(1) debentures of companies with limited liability;

(2) goods which, or the documents of title to which, are deposited with them, assigned or hypothecated to the Bank as security for such advances;

(3) joint and several pro. notes of two or more persons or firms unconnected with each other in partnership;

(4) fully paid marketable shares of companies with limited liability or immovable property or documents of title relating thereto, as collateral security only, where the original securities are one of those specified above; and

(5) marketable shares of companies with limited liability registered in the Dominions, which may carry the Government guarantee or be placed by the Government, from time to time, on an approved list.

Any advance, which is guaranteed by the Government can be given with or without any specific security. The bank is also authorised to transact such other business on behalf of the Government, not specifically mentioned in the schedule, as may be agreed upon between the Government and the Bank. With the previous sanction of the Government, the Bank is also authorised to lend money to the Court of Wards in the Dominions on the security of the estates in its charge or under its superintendence.

15. With the impending constitutional changes, the Council of Ministers have decided that a separate Bank to perform the central banking functions should be started, which would be a national concern owned by the State and completely managed by Government and which would be in keeping with the policy that is being followed elsewhere; such as the nationalisation of the Bank of England and the proposed nationalisation of the Reserve Bank of India. This decision may be attributed to the growing realisation that, under modern conditions of banking and commerce, it is a great advantage to any country, irrespective of the stage of its economic development, to have centralised cash reserves and the control of currency and credit vested in a bank, which has the support of the State and is subject to some form of State supervision and participation, whether directly or indirectly.

16. The Hyderabad State Bank has developed into a full-fledged commercial Bank and it cannot now be converted into a purely Central Bank without depriving it of its commercial banking functions. The experience of the first five years working of the Hyderabad State Bank has clearly brought out the inherent weakness of a system in which the control of currency and credit is in the hands of two distinct authorities. It has brought out the necessity of a unity of policy in the control of currency and credit in a modern financial organisation, if monetary stability is to be achieved.

17. It has been suggested that instead of starting a separate Central Bank, the Hyderabad State Bank may be divided into two separate departments—the Issue and the Banking Departments—and that the former may be entrusted with central banking functions, including issue of notes, and that the latter may be free to conduct commercial banking functions, *under certain conditions and restrictions*. Thus, for example, the bank will not be allowed to accept interest bearing deposits or to grant loans on the security of marketable shares or immovable property. The bank will be authorised to lend money against gilt-edged securities, but their advances against goods or the documents of title to goods, will be limited to a certain percentage of their total assets. Subject to the above restrictions it is felt that it is possible to carry on central banking functions and commercial banking in one and the same institution, provided the Issue and the Banking Sections are kept entirely separate under two different controlling authorities and a separate body of expert advisers, and the Hyderabad State Bank is completely nationalised by paying off the existing shareholders of the bank. The controlling body for the Issue Department will consist entirely of State Officials with Finance Minister as its President and, if necessary, one or two elected members of the State Legislative Assembly; but the Banking Department will also have on its Board representatives of financial, agricultural and industrial interests of the State. The guiding principle for the Bank would then be to act only in the public interest and for the welfare of the country as a whole and without regard to profit as a primary consideration. The general idea behind the system would be to make full use of the credit of the State and to see that the economic resources of the Dominions are put to the utmost advantageous use possible in the interests of the people, and to make it certain that the Bank would ensure the interests of Hyderabad as a whole and not the interests of one or the other section of the community.

18. It is also felt that if the Hyderabad State Bank is converted into a national institution, as suggested above, it would be possible, at a later stage, to organise, under the same expert management, separate sections for industrial and agricultural credit, including the organisation of a Land Mortgage Bank for Hyderabad.

C. B. TARAPORVALA,

Addl. Financial Secretary,

26-5-47.